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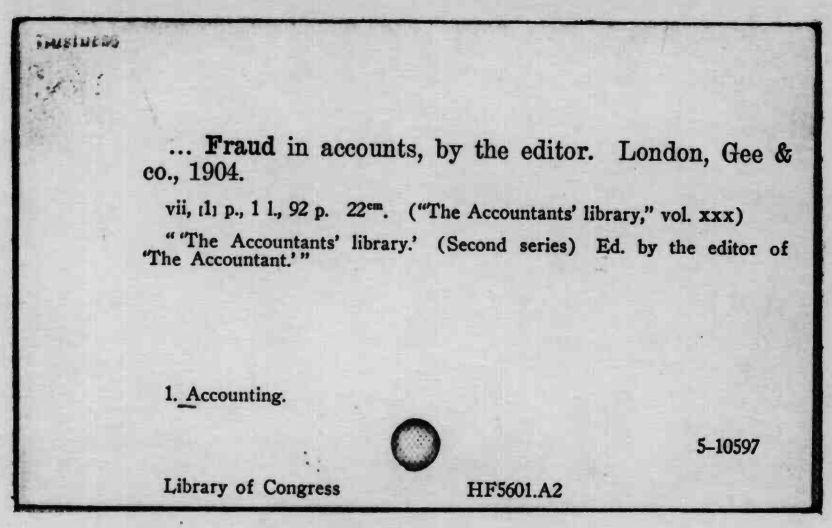

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vii, [1] p., 1 l., 92 p. 22cm. ("The Accountants' library," vol. xxx)

"'The Accountants' library.' (Second series) Ed. by the editor of 'The Accountant.'"

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Library of Congress HF5601.A2

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# EDITOR'S PREFACE.

THE object of the series of handbooks that is being published under heading of THE ACCOUNTANTS' LIBRARY is to provide, at a reasonable price, detailed information as to the most approved methods of keeping accounts in relation to all the leading classes of industry whose books call for more or less specialised treatment. No such series has hitherto been attempted; but there exist, of course, numerous separate works dealing with the accounts of one particular class of undertaking. These separate works are, however, for the most part either too expensive, or too superficial to answer the purpose that is particularly aimed at by THE ACCOUNTANTS' LIBRARY, which is intended to supply the student with that specialised information which he may require, while at the same time affording to the trader, banker, or manufacturer who is not in a position to secure the fullest information for his purpose, knowledge which can hardly fail to be of the very greatest assistance to him in the correct keeping of his accounts, upon a system specially adapted to his requirements, and therefore involving a minimum expenditure of labour. It is expected that the series will also be found of material assistance to bookkeepers of all classes.

Without aiming at giving an exhaustive account of the manner in which each separate business is conducted, the technical points in connection with each industry will receive as much attention as is necessary in order fully to elucidate the system of accounts advocated, while each volume will be the work of one who has made that particular class of accounts more or less a speciality. It is obvious, however, that to enable the necessary ground to be covered in the space available, it is incumbent to assume upon the part of the reader a certain knowledge of general bookkeeping. The extent of the knowledge assumed will vary according to the nature of the class of accounts considered. For example, in the volumes on "Bank Accounts" and "Shipping Accounts," a thorough acquaintance with ordinary double-entry bookkeeping is not unnaturally assumed; but in the case, for instance, of "Auctioneers' Accounts," "Domestic Tradesmen's Accounts," and other similar volumes, such explanations are included as will enable the ordinary intelligent reader fully to grasp the methods described even although his knowledge of bookkeeping may be of an elementary description. These explanations are, doubtless, superfluous as far as accountants are concerned, but are necessary to make the volumes of value to the majority of those specially engaged in these particular industries.

To subscribers for the whole series it may be added that, when completed, it will form a most valuable and practically complete library, dealing, at the hands of specialists, with practically every class of accounts, and illustrating the application



of the theory of double-entry as described in general works on bookkeeping.

The first series (of twenty volumes) has already been completed, and particulars of the subjects dealt with will be found on p. i. A second series (which will comprise about thirty more volumes) is now in progress, which when issued will complete the scheme. Many of these have already been arranged for, but the Editor will be glad to receive suggestions and offers from accountants of experience for the undertaking of volumes not yet announced.

34 Moorgate Street,
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*June* 1903.

# FRAUD IN ACCOUNTS.

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# FRAUD IN ACCOUNTS.

## CHAPTER I.

## INTRODUCTION.

THE subject dealt with in this volume is one which, owing to its very nature, is not capable of systematic treatment. Accounts may be stated to be fraudulent when, to the knowledge of some person or persons concerned in their preparation, they record non-existent transactions, omit to record transactions that have actually taken place, or incorrectly or incompletely record such transactions. The result in each case is identical—the books do not disclose the true position of affairs, and any summarised accounts compiled from those books (*e.g.*, the periodical Balance Sheet and Profit and Loss Account) are to a corresponding extent incorrect. All falsified accounts have this much in common; but no more. The motives underlying deliberate falsification are numerous, and the methods adopted extremely varied. If a certain specified system of accounts were to be taken as a basis, it would be possible to deal systematically with the question of the various conceivable manners in which those accounts might be falsified; but such a restricted inquiry would be of but little use, save to those using the actual system of accounts selected. Such a method of treating the subject would be quite impracticable, if it be decided to deal with it upon general—and therefore upon useful—lines.

Under these circumstances it has been thought best to, in the first place, indicate in general terms the principles upon which the system of checking the books of a concern should be framed, and the manner in which the necessary work may be conveniently apportioned among the various parties concerned. It is then proposed to deal with the subject in detail under broad headings; while, by way of completeness, an Appendix has been added containing extracts from those statutes that bear upon the subject.

It is important to remember that all systematic falsification of accounts must have some motive, and a study of the motive may not infrequently lead to a discovery of the method employed. Accounts may, of course, be grossly inaccurate without those responsible for the inaccuracies having any definite motives for what they have done; but such cases can hardly be said to come under the heading of "fraudulent" accounts, although it need hardly be added that—upon the principle that the greater includes the less—the employment of an adequate system of detecting fraud in accounts will incidentally discover any errors that may have been committed through ignorance or inadvertence. It is, however, of course the deliberate falsifications of the fraudulent that present the most difficulty, and in connection with these, as has been stated above, an inquiry into motive is not without value. The motives of the falsifier may be divided into two classes:—

(1) Accounts may be falsified with a view to, so far as possible, concealing an absolute *theft*, either of money or money's value.

(2) Accounts may be falsified because, for various reasons, it may be desired to conceal the true results of the operations of the undertaking for the period under review.



Frauds coming under this second heading are in general the most difficult of detection, because experience shows that they are frequently committed by persons who under no circumstances whatever would actually steal the property of another; consequently, as often as not, they appear to be perpetrated by those in responsible positions, concerning whose actions the critical faculty of those charged with the duty of checking the books is apt to be dormant. In any event, and under any system of check, persons enjoying a responsible position must of necessity be in a better position to falsify accounts without immediate detection than those occupying a subordinate position. Moreover, such check as the system employed may impose upon them will, in part at least, have to be carried out by their subordinates, and there is thus in practice always a considerable risk that this portion of the work will, either through carelessness on the part of the subordinate or through the influence of his superior, be found to have been ineffectively performed. An adequate system of check will go far towards minimising the risk of loss through fraudulent conduct, by making the ultimate discovery of the culprit and the fixing of definite responsibility upon him a mere question of time; but no system can altogether eliminate the risk of losses of this description, nor in the nature of things can irregularities be detected until after they have been committed. The aim of every system of check should be to detect them as soon after committal as possible; but, as will be evident from a study of these pages, if a person occupying a position of trust and responsibility falsifies the accounts, in the nature of things a longer interval must elapse before its discovery than would be reasonable in the case of those occupying a more subordinate position. This is inevitable, bearing in mind the diverse opportunities of the two classes. The accounts of subordinates

can, and ought to, be exhaustively checked at frequent intervals, and upon each such occasion outstanding irregularities ought to be capable of being detected; but the accounts of those occupying a more responsible position cannot be checked so frequently, nor is any system of check that can be employed so absolutely definite. Again, the latter class of falsifier can frequently achieve his purpose best by falsifications involving questions of principle, or opinion, rather than questions of fact, which of all are in the nature of things the most difficult to detect at once. At the same time, it is thought that the immunity that has been for so long enjoyed by many perpetrators of this class of fraud has been due to the neglect of reasonable precautions, rather than to the impossibility of applying any really effective system of check to control their actions.

## CHAPTER II.

## THE FUNCTIONS AND LIMITATIONS OF AN AUDIT.

WHENEVER an elaborate system of falsification is discovered it is usual for an outcry to be raised against the Auditors, and if the fraud has been of a somewhat sensational character—thus making good "copy" for the daily Press—this ill-considered view of the matter is, as a rule, particularly emphasised. It is probable that there have been no cases of fraud discovered of recent years on which one or another of the newspapers has not gravely commented upon the inutility of an audit, and published letters from correspondents (generally anonymous) accusing the Auditors of negligence or other improper conduct. It is desirable that it should be pointed out at an early stage in the course of this work that a professional audit—like any other human institution—has its limitations and also its limits; but it is also desirable to add that these need not interfere with its general efficiency, or its value as a precaution against the presentation of inaccurate accounts.

It is thought that a good deal of misunderstanding may be removed by a clear statement as to what a professional audit really consists of, and what the certificate of the Auditor means. A complete consideration of this subject is, of course, impossible within the limits of the present volume; but it may be pointed out that, in spite of slight—and for the present purposes immaterial—differences, the duties of the Auditors of

public companies of all kinds (including under this heading Building Societies, Friendly Societies, and the like) are to report to the proprietors of the undertaking upon the accuracy of a Balance Sheet and accompanying accounts prepared by, or on behalf of, the Directors of that undertaking from its books. The general purport of the accounts that have to be certified is practically identical in all cases. One account purports to show the financial position of the undertaking upon the date named, other accounts purport to summarise its transactions during the period then brought to a close. Inasmuch as a number of these transactions will (in the case of a going concern) be pending at the date of the accounts, it is clear that it is only up to a point that it is humanly possible to attach any money value to them as representing their actual effect upon the position of the undertaking as a whole. Upon matters of estimate it is but reasonable that *bonâ fide* differences of opinion should occur from time to time, and within all reasonable limits the Directors —whose the accounts are—are clearly entitled to put forward their view. At the same time, the duty devolves upon the Auditor of forming his own opinion, and expressing it. Unquestionably, if he doubts the *bona fides* of the opinion expressed by the Directors upon the face of the accounts submitted for audit, his course is clear; but where, on the other hand, he is convinced of the *bona fides* of the accounts, and doubts only the wisdom of the opinion upon which they have been based, it is clearly a question of weighing one opinion against another. For some purposes the opinion of a professional Auditor (being that of an expert in accounts) may be more valuable than the opinion of a Board of Directors. For other purposes the opinion of a Board of Directors (being, presumably, experts in that particular business) may be presumed to be more likely to be valuable than the Auditor's; but, of course, if the Auditor does not feel that he can



honestly defer to the opinion of the Directors, then it is his duty to report his own views to the proprietors. This is the course usually adopted in practice, and experience shows that under such circumstances the opinion of the Auditor is almost invariably ignored by the proprietors, and the opinion of the Directors upheld. Particularly is this course likely to be pursued if the adoption of the Auditor's view would have the effect of reducing the amount of divisible profits.

The above, it is thought, summarises the statutory duties of an Auditor, and, as will be seen from a perusal of this volume, these statutory duties provide only very inadequately for the detection by him of ordinary falsifications on the part of the staff; while, with regard to falsifications perpetrated by those in a responsible position, the decisions of the Courts show clearly that an Auditor is justified in accepting the statements of those who are in a responsible and trusted position, if those statements appear to be reasonable in themselves, and also provided the Auditor himself believes them to be true. The statutory audit, therefore, is not an effective safeguard against fraud, although it must not on that account be supposed that every conceivable kind of fraud or falsification might be perpetrated without the Auditor incurring any responsibility for non-discovery. At the same time, viewed broadly, the facts of the case undoubtedly are that, in the absence of an express contract between the parties, an "audit" (as the term is ordinarily understood at law) is an inadequate protection. Of course, most professional Auditors carry their investigation far beyond the limit of their legal responsibility; and so far as personal reputation is concerned, it is clear that an Auditor who fails to discover irregularities, even if he has discharged his legal obligations, cannot be regarded as of conspicuous ability. But, however that may be, it will be seen that, if it be desired to

take all possible precautions against falsification of accounts, it is desirable that attention should be specially directed towards that end, and that, so far as may be necessary, the bare statutory audit should be supplemented, with a view to covering every possible leakage.

In all save quite the smallest concerns it would be manifestly impossible to expect the Auditor, either personally or with the aid of his own staff, to verify every entry in the books. Apart from the excessive cost of such an arrangement, it would involve the audit taking place practically during every hour throughout the year, which would materially interfere with the conduct of business; moreover, much of the work involved can be even better performed by those who have had a practical training in the business carried on, rather than a special training in accounts. From every point of view, therefore, the first step in the direction of safeguard against fraud is to so organise the existing staff, and to systematise the duties of each member of that staff, as to enable them to a large extent *to check the work performed by each other*, leaving to the Auditors the duties of seeing that this system of internal check is properly carried out, that it has not been rendered ineffective by alterations in the manner in which the business is carried on, and that the isolated records of transactions, as thus verified in detail, are properly put together, so that their combined effect may truly represent the state of the undertaking as a whole. If there be an adequate system of "internal check," properly conducted, as a basis or foundation, with but little (if any) additional work, the Auditor may conduct his audit in such a manner as to afford all reasonable safeguards against falsification. When, therefore, those responsible for the conduct of the business are prepared to initiate such a system of internal check, they may reasonably expect—provided they employ reputable firms of accountants—



that a professional audit will do all that is needful to protect them against falsification and fraud; at all events, to the extent of insuring an early discovery. But if, on the other hand, those responsible for the conduct of the business expect the professional Auditor to conduct a system of internal check in addition to his audit, and, moreover, to conduct it without any additional charge, their attitude is manifestly unreasonable, and the result is almost certain to be unsatisfactory.

## CHAPTER III.

## SYSTEMS OF INTERNAL CHECK.

As has been pointed out in the preceding chapter, a professional audit, whatever its other advantages may be, is of but little value as a means of preventing or speedily detecting fraud, unless it rests upon a clearly defined basis of internal check. The point that thus naturally calls for inquiry in the next instance is the system upon which this internal check should be founded. Speaking generally, the larger the book-keeping staff, the more easy does it become to organise a really complete system of staff audit; but, that the principles underlying the system may be more clearly comprehended, it is perhaps best in the first instance to start with a consideration of comparatively small undertakings, and to proceed upwards by stages.

In concerns of this description it would not, in the ordinary course of events, be imposing too onerous a task upon the proprietors to suggest that they should keep a close supervision upon all entries made in the books of first entry, with a view to seeing that every transaction is completely and correctly recorded as it takes place. Such a supervision should be conducted, if not daily, at very frequent intervals, and should (for obvious reasons) extend to, and pay particular attention to, the entries in the Cash Book. If the principal can see his way to verify the complete and correct record of all transactions in



books of first entry, the Auditor has, of course, at once a definite and reliable basis upon which to start his investigations, and from that point onwards, in the comparatively small concerns that are at present under consideration, no difficulty will arise in the way of a complete and absolute verification of the accounts—subject only to those necessary limitations that must at all times apply to the accounts of a going concern, which, by reason of its being a going concern, must include a more or less arbitrary valuation in money of many pending transactions. This difficulty of valuing pending transactions has, however, under these circumstances no bearing upon the point immediately at issue; for, with a comparatively small concern, where the proprietors can themselves keep their hands upon the reins, it would be impossible for any employee to conceal fraudulent transactions by an improper valuation of pending items. The risk of fraud being concealed by this means is exclusively confined to cases where control is vested in persons who themselves have to be supervised. It is, of course, not inconceivable that one partner might deceive another; but even this contingency has but little bearing upon the problem now under consideration, in that in comparatively small undertakings it ought not to be a difficult matter for each separate partner to keep in sufficiently close touch with the transactions to render it impossible for him to be deceived as to actual facts. If each partner is prepared to vouch for the facts, and for their record in the books of first entry, a competent accountant will experience no difficulty in telling him with certainty the aggregate effect of these transactions.

As the concern increases in size and the number of transactions engaged upon becomes larger, and their relative importance more considerable, it follows in the ordinary course of events that a larger staff becomes necessary to keep pace with the

prompt record of these transactions in the books of account. Simultaneously the proprietors would experience a corresponding, and increasing, difficulty in devoting the necessary amount of time and attention to checking the original records of these transactions, until at length the point would be reached when it would be physically impossible for them to do so on account of the number of the transactions involved. Long before this stage, however, it would become undesirable for them so to devote their energies, for it is only reasonable to assume that the time would have been reached long ere this when the energies of proprietors can be more usefully and profitably expended in other directions. Simultaneously, however, with the enlargement of a business concern upon these lines, rendering the close personal scrutiny of the proprietors into every transaction impracticable, it will be found that the necessity, and even the desirability, of proprietors so occupying themselves becomes increasingly less apparent. With a proper system of organisation this duty of verifying the original record of transactions may be deputed to members of the staff, upon the general principle that every member of the staff is responsible for the accuracy of all the records that he makes, and that at least one other member of the staff is deputed to check this record, and to become additionally and especially responsible for its correctness. With a very small staff this allocation of duties, so that each member of the staff may be a check upon some other, is often a question of some little difficulty in practice; but directly a staff of reasonable proportions is assumed these difficulties vanish, and a complete system of internal check becomes not merely practicable, but also convenient and desirable from every point of view.

The exact allocation of duties, so that the general principles involved may at all times be retained in their entirety, is a



matter that can only be determined in detail after a full inquiry into the circumstances of each individual case. The professional Auditor should therefore invariably be consulted, so that (*a*) the system of internal check may be complete in itself, (*b*) it may be carried out in its entirety with the minimum of expense and interference with the practical carrying on of the business, (*c*) it may be carried out upon such lines as to give the Auditor so sure a foundation for his further examination as will make it reasonable to expect him to assume full responsibility from that point onwards.

But although the actual adjustments upon matters of detail must be necessarily left for final decision according to the circumstances in each separate case, the underlying principles may be readily defined. They are as follows:—

(1) Those upon whom devolves the duty of handling money should be made individually responsible for all cash belonging to their departments. This, of course, throws upon them the responsibility of seeing that all cash transactions relating to their particular departments have in point of fact passed through their hands, and of reporting any irregularities in this respect. All cashiers, whether chief or departmental, should have their respective responsibilities clearly defined and placed upon record from day to day, and no cashier should under any circumstances be entrusted with the duty of posting entries to any Ledger to which his cash transactions will be posted. Where practicable, cashiers should be kept absolutely separate from Ledger clerks, but in the case of medium-sized concerns it is often essential that the chief cashier should be also the head of the counting-house. Under these circumstances subsidiary cashiers should be responsible (in sections) for each portion of the aggregate cash, so that the records of these subsidiary cashiers may provide a definite check upon the record kept by

the chief cashier himself. Under no circumstances should a departmental cashier be allowed to keep a corresponding Departmental Ledger.

(2) All books, whether financial or statistical, should be kept by double-entry. They should also be kept upon self-balancing principles, so that the clerical accuracy of each separate Ledger may be independently tested. These tests should take place at frequent intervals, as frequently as is practicable without seriously interfering with the daily conduct of business, and the tests should be exclusively conducted by clerks *other than the one in charge of the Ledger in question*. That is to say, no Ledger-keeper should be employed to call back, or to assist in calling back, the postings to his own Ledger; to extract, or to assist in extracting, the balances of his own Ledger; or, indeed, in any of the processes connected with the verification of the accuracy with which that Ledger has been kept.

(3) The duties of each individual member of the staff should from time to time be clearly defined, and *no member of the staff should be allowed to exceed his duties*, even to the extent of temporarily assisting others with their work, save by express instructions from the head bookkeeper. From time to time, at such intervals as prudence may suggest, the respective duties of the various members of the staff should be shifted about *inter alia*, and in particular no clerk—not even the chief bookkeeper—should under any circumstances be allowed to make entries in any book that is not for the time being under his exclusive care. Not less than once in every twelve months every member of the staff should be required to altogether absent himself from the office premises, so that during that interval of time at least he may have no opportunity whatever of controlling any entries in the books of account. This last suggestion can,



of course, be readily accomplished, if the holidays of the staff are managed upon a regular and systematic basis.

The especial importance of each of these provisions will be duly appreciated as the latter part of this work is perused, and in particular it will be noted that practically every recorded act of fraud upon the part of subordinates has been caused—or at all events facilitated—by neglect to observe one or another of these rules.

The due supervision of those who, for purposes of brevity, may be described as "seniors" is in the nature of things a far more difficult matter. Under this heading must be included not merely those employees occupying a position of responsibility, but also individual partners of a firm, and directors (and especially managing directors) of companies. The difficulty of applying any system of internal check so as to act effectively in these cases is, as has already been stated, emphasised by the purely human consideration that it is extremely difficult to get subordinates to really carry out a system that *will* act as a check upon their superiors, and also by the fact that such a system, even if effectively introduced in the first instance, can in practice often be so modified by the persons against whom it is imposed as to render it for all practical purposes useless. Moreover, a subordinate who carries out such a system conscientiously, and discovers as a result something that suggests a ground for suspicion, is at a loss, in that the person to whom he should, under ordinary circumstances, report his suspicions, is the very person whose conduct is being impugned. It must be admitted, therefore, that, under all ordinary circumstances, the limitations of even a very thorough system of internal check are such that it *may* break down when the actions of the responsible seniors are in question. That, however, is no argument against the installation of such a system; for even if it did not

act quite so unerringly or so quickly as in connection with the misdemeanours of juniors, it would, at least in so far as it went, act as a deterrent, and also afford evidence which at a later stage might be found of the utmost value in definitely fixing responsibility.

The question of definitely fixing responsibility upon the right shoulders is by no means the least important part of a system of internal check. It is now possible to "insure" against loss caused by dishonesty at quite reasonable premiums; but policies of insurance designed to cover such a risk are, of course, issued under certain conditions, and one of these conditions is that the assured will prosecute the offending party if called upon to do so by the insuring office. Should the prosecution prove unsuccessful nothing can be recovered under the policy of insurance, and therefore in all contested cases the policy of insurance is valueless, unless the criminal responsibility of the defaulting party can be actually proved to the satisfaction of a Court of Law. It would be beyond the scope of the present work to indicate in detail the material distinction that obtains between such evidence as is necessary to secure the conviction of a person accused of a criminal offence and such evidence as is sufficient to satisfy any reasonable business man that a business house has suffered pecuniary loss through the dishonesty of one or another of the persons it employs. The distinction is, however, a very material one, and its practical importance, as affecting the question whether an insuring company is liable to make good the loss sustained, cannot easily be exaggerated. That being so, quite one of the most important points to be borne in mind in designing any system of internal check is the necessity of so separating the responsibility of individuals that the records which it is designed shall be kept from day to day shall in themselves, so far as possible, provide such documentary



evidence as may be necessary to insure that all responsibility for irregularities may eventually be fixed upon the right shoulders.

By way of conclusion to this chapter a few general rules are added, which, under all normal circumstances, might with advantage be rigorously enforced. In every case they will doubtless require to be supplemented by other special rules, designed to meet the requirements of that particular instance, but so far as they go they will prove useful as an indication of what has to be aimed at. It only remains to add that any system, however perfect in itself, that is not rigorously enforced *at all times without exception*, must in the nature of things be expected to break down at the time when it is most likely to be required in practice—namely, when irregularities have occurred. Those upon whom devolves the duty of definitely settling the system of internal check to be employed in any particular case should do so after a full consideration of all the practical requirements there obtaining, and of the inconvenience that any rigorously enforced system may cause at exceptionally busy times when everyone is called upon to work at high pressure; but when once the system *has* been settled, it is absolutely essential that it should thereafter be at all times carried out to the letter. The failure of anyone to carry out his portion of the system, or to (so far as lies in his power) insist upon its being carried out by others, must in all cases be looked upon as a circumstance which *primâ facie* suggests grounds for the gravest suspicion against the honesty of that particular individual.

Speaking in general terms, the following rules may be looked upon as being of practically universal application:—

(1) All persons charged with the custody of cash should be required to keep a complete record of their dealings, which should from day to day be verified by someone whose ordinary duties are quite independent of these transactions.

(2) When several Cashiers are employed, the records should be so arranged that the Chief Cashier may check each of the Departmental Cashiers, who must account to him daily; while the records of the Departmental Cashiers should check the Chief Cashier.

(3) No one having the handling of any money should have the control of any Ledgers to which those moneys must be posted.

(4) All moneys received should be paid into the Bank daily without deduction.

(5) All payments (other than Petty Cash payments) should be made by cheque, even if the amount involved be quite small.

(6) The Petty Cash Book should be kept upon the "Imprest" System, and the floating balance kept so small as to *compel* the settling of accounts between the Petty Cashier and the Chief Cashier at frequent intervals.

(7) In those exceptional cases where the payments necessarily made in cash are considerable, rather than enlarge the functions of the Petty Cashier a separate Paying Cashier should be instituted, whose accounts should be kept upon the "Imprest" System, and who should be called upon to account to the Chief Cashier daily.

(8) Under no circumstances should the same Departmental Cashier be entrusted with both the receipt and the payment of moneys.

(9) A regular system should be in force for the acknowledgment of all moneys received upon the prescribed receipt form. (The exact nature of this form is considered in detail later.)



(10) Proper vouchers should be obtained for all payments made, whether by cheque or by cash. The system, that is very generally in use, of requesting payees to acknowledge the receipt of money upon a stereotyped form supplied by the payer is greatly to be deprecated, on account of the facility with which such vouchers may be forged by a dishonest Cashier.

(11) All persons in charge of money should be required to balance up the moneys in their hands at least once a day, and the constitution of that balance should be placed upon record in a book specially provided for that purpose. Balances handed over by Departmental Cashiers to the Chief Cashier should be signed for by the latter in the "Balance Books" of the former.

(12) Whenever possible someone in authority should make it his business to examine the constitution of all paying-in slips, with a view to seeing that they really represent the whole of the moneys received during the period purported to be covered.

(13) The balance of every Bank Account should be verified at least once a week by someone who has not had the handling of any money passing directly from him to the Bank.

(14) All Ledgers should be kept upon "self-balancing" principles, and the accuracy of their balancing tested at frequent intervals by persons who are not responsible for the keeping of those Ledgers, nor for the handling of the moneys posted thereto.

(15) Subsidiary accounts, whether kept in money or in quantity, should in all cases be checked in the same systematic manner as those accounts that form part of the financial system of bookkeeping. If these accounts are to serve any purpose at all, their absolute accuracy is imperative; while experience shows that accounts that form no part of the regular system of

bookkeeping are often kept carelessly, even when no dishonesty is to be implied.

(16) Such accounts as Stock Accounts, Cost Accounts, and the like, should in all cases be supervised and verified by persons who are not directly responsible for the satisfactory, or profitable, nature of the results shown by these accounts.

(17) A regular system of internal check should in all cases be in force, with a view to guarding against any invoices for goods received, or services rendered, being entered in the books of account, and passed for payment, without due certification of the fact that the goods have been received, or the services rendered, as the case may be.

(18) In like manner an adequate safeguard should be provided against goods being allowed to leave the business premises without being charged up as Sales.

(19) So far as may be necessary, in view of the particular class of business carried on, due precautions should be taken to see that all expenditure incurred, of whatsoever kind, is debited to the proper accounts, whether nominal or personal.

(20) Special care should be taken with a view to guarding against any allowance being made to customers in respect of returns, overcharges, &c., without full and proper inquiry.

(21) In the like manner due precautions should be taken to see that all claims against creditors in respect of allowances, returns, or overcharges, are in due course followed by credit notes.

(22) Under no circumstances should any payment ever be made without two or more persons being made responsible for its correctness.

(23) Especial care should be taken to supervise the collection of Book Debts, with a view (*a*) to seeing that no preventable



losses are incurred through careless collection; (*b*) that all moneys actually received are duly accounted for, and paid into the bank upon the date when actually received.

(24) Large payments in cash—*e.g.*, Wages—require very special precautions to guard against fraud. The exact steps to be taken will in all cases depend largely upon the general business methods adopted, the general principle being, however, in all cases identical—namely, to make two (if not more) persons responsible for the work *at each stage*.

(25) It is important to bear in mind at all stages of a system of internal check the point referred to upon page 22—namely, that falsification of accounts is not by any means necessarily employed solely as a means of concealing the actual misappropriation of money. Entries that do not purport to record the receipt or payment of money must therefore be in all cases verified with the same scrupulous carefulness as cash receipts or payments. The importance of this point is greatly emphasised by the fact that it is so little understood in practice, many persons being far less careful in their record of transactions other than cash, or in their checking of such records, than they would recognise as being necessary for the adequate discharge of their duties in connection with money entries. As will be seen later on, material falsifications may remain concealed by entries being passed to the credit of the wrong account; yet, in the absence of most explicit instructions, the class of persons ordinarily entrusted with the duty of recording the issue or receipt of articles other than cash (*e.g.*, consumable stores) would undoubtedly regard it as of no material importance whether the item was entered up to one account or another, so long as the correct amount was recorded. Hence the importance of strict explicit instructions being given upon such points.

## CHAPTER IV.

## MOTIVES AND METHODS OF FRAUD.

If any useful purpose were to be served thereby, it might be worth while to make an attempt at classifying frauds into

(*a*) Falsifications on the part of employees to conceal embezzlements.

(*b*) Falsifications on the part of employees to conceal the theft of goods, other than money.

(*c*) Falsifications on the part of employees to magnify profits, in the hope of securing a continuance of their position at the same (or an increased) salary.

(*d*) Falsifications on the part of partners, with a view to misrepresenting the position to their co-partners, or to deceiving creditors.

(*e*) Falsifications of directors, with a view to:

(1) Tiding the company over a difficult period.

(2) Securing the payment of the expected dividend, and thus the maintenance of the market price of shares.

(3) Securing their continuance in office, with the fees attaching thereto.

(4) Manipulating the market price of shares, with a view to securing profits on dealings therein.

The above summary does not, of course, exhaust all possible motives for the falsification of accounts, although it will doubtless be found sufficiently suggestive for most practical purposes.



From that point of view it will probably be useful, and it is for this reason that it has been mentioned; but it is desirable to add that too much supposition, and too much attempting to differentiate motives with a view to guessing at probable methods, will be found extremely undesirable in practice. It is only in theory that such a classification may be usefully attempted. In practice most omissions, and particularly most irregularities, are committed from a mixture of motives, and the precise method of wrong-doing employed will vary far less with the motive than with the opportunities afforded by the precise system of accounts in use, and the systems of internal check and of audit that may be employed to guard against errors and irregularities. For these reasons no attempt will be made to classify the recited instances of fraud into any hard-and-fast groups, and those upon whom devolves the task of preventing or detecting frauds may be cautioned against approaching their work from the point of view which has here been deprecated. The failures of the past may, of course—and, indeed, should be—utilised to their utmost capacity, with a view to avoiding similar failures in the future; but such applications must be made upon broad and liberal lines, bearing in mind that the opportunity, rather than the motive, will in all cases determine the method of falsification employed. Hence the importance in the first instance of a full inquiry into the actual system in use, and the exact methods employed (not merely in theory, but also in practice), in order to make sure that the system is really carried out in its entirety.

When a defalcation is sought to be concealed by falsification of accounts, then, if the book be kept by Double-entry, there must be *two* falsifications, or the book will not balance. For this reason *inter alia* Double-entry is greatly to be preferred to Single-entry. At the same time, it should on no account be forgotten that the accounts may be false, and fraudulent, and

yet balance exactly: still, with Double-entry there is the double chance of detecting the falsification, for the opportunity is afforded of considering its effect upon the accounts from two points of view.

With these preliminary observations a brief recital of the salient features of various methods of fraud that have from time to time proved successful for longer or shorter periods may be proceeded with. In some instances it is probable that the precise case referred to may be sufficiently identified by the unusual character of the means adopted. Other instances will present less distinctive features, and will therefore not be capable of such ready identification. The omission of all names in connection with these various instances is deliberate; because, were the cases referred to to be clearly identified, criticism of the adequacy of the methods in force would necessarily have to be somewhat curtailed, whereas if the various matters be dealt with in general terms, as possible—or even probable—defective systems of accounts *per se*, without any names being mentioned, it becomes practicable to indulge in a freer, and therefore more effective, form of criticism without incurring any possibility of libelling parties, who might otherwise perhaps feel themselves aggrieved. The suppression of names, by removing the personal factor in the matter, will perhaps to some extent detract from the interest of this volume to the casual reader. That, however, is a matter of comparatively small importance. The thoughtful student of accounting, to whom this work is addressed, will require no such extraneous stimulant to his attention; while it must be admitted that the question of fraudulent accounts, and the safeguards desirable to guard against falsification, constitute a subject which may be discussed more impartially—and in consequence more scientifically, and more usefully—if the personal element be entirely eliminated.

## CHAPTER V.

## SPECIFIC INSTANCES OF FRAUD, INVOLVING MISAPPROPRIATIONS OF MONEY.

THE employment of cheques, instead of coin, in business transactions is to be advocated in all cases where practicable, as materially reducing the risks of fraud. If a system could be devised under which *all* business transactions could be settled by the payment of a paper currency which could not possibly be converted into money by employees, more than half of the existing risk of loss through dishonesty would be at once eliminated. Such a system has not hitherto been devised, but in the meanwhile it is clearly desirable that all business people should, so far as possible, constitute their bankers as their cashiers, and thus reduce their risk of loss to a minimum. Persons who have occasion to remit money should in all cases be requested to do so either by Cheque, or by Money or Postal Order, "crossed" to the bankers of the firm, payable to the account of the firm, and marked "Not Negotiable." As the effect of these precautions is but little understood, it is desirable that it should be described in detail. The effect of crossing a cheque to a particular bank, thus

GLYN, MILLS, CURRIE & *CO.*

is to make it impossible for anyone to obtain payment of that cheque, save through the agency of the bankers named. If the

creditors' bankers be unknown, a limited measure of security may be obtained by "crossing" a cheque "generally," thus

*& CO.*

The effect of which is to make it impossible to obtain payment of that cheque, save through the agency of *some* banker. The "special" crossing is, in the nature of things, a more perfect safeguard, as it *pro tanto* limits the opportunities of an illegal holder to obtain payment, but even a "general" crossing is better than no crossing at all, because the intervention of any banker's services leaves behind it some record which may help to trace the irregularity; while without a crossing—special or general—the further safeguards about to be enumerated cannot be put into force.

If in addition to crossing a cheque, either specially or generally, the words be added "Account of A. & B.," the effect of those words is often thought to be that the banker through whom the cheque is presented for collection has thrown upon him the obligation of seeing that the proceeds of the cheque, when cashed, will be placed to the credit of A. & B., who are his customers. This popular impression is, however, quite unfounded. It is questionable whether such a qualification throws any duty whatever upon the collecting banker; it certainly throws no duty upon the bankers of the drawer of the cheque, who in the nature of things can have no opportunity of ascertaining to whose credit the collecting banker will place the proceeds of the cheque. But although there is no definite legal meaning to such a qualification, it has at least this value in practice, that whereas any business house is quite justified in handing cash, to someone whom it has reasonable ground for supposing to be its true holder, for the face value of a cheque



endorsed by the payee, yet if such cheque be crossed as payable to the account of some particular individual, or firm, it would be *primâ facie* irregular to ask anyone else to present it through their bankers for payment. Consequently anyone changing a cheque so crossed would be put upon inquiry, and if they changed it for a person who had no legal title to it, they might very likely be held to be liable to refund to the true owner the amount thereof. Thus, although no special statutory meaning attaches to the crossing to a particular account, it is for practical purposes a desirable additional safeguard. Of course, a cheque cannot be made payable to the account of some particular person, unless it is also "crossed," either specially or generally.

If the words "Not Negotiable" be added to the crossing of a cheque, their statutory effect is that every holder of such cheque, or every person claiming to be a holder, can under no circumstances put forward a better title than the person from whom he, in point of fact, obtained it. *Bonâ fide* holders for value who have obtained a cheque from someone who has stolen it cannot therefore retain it, as against the true owner, nor can they sue the drawer for the amount thereof. Any person changing a cheque marked "Not Negotiable" for the payee, or for any person purporting to be the true holder thereof, consequently does so at his peril. Of course, the words "Not Negotiable" are meaningless unless they appear in conjunction with the "crossing" of a cheque, either specially or generally.

A complete "crossing" would thus appear in the following form:—

GLYN, MILLS, CURRIE *& CO.*

*A/c of* A. & B.

NOT NEGOTIABLE.

It will thus be seen that the employment of cheques payable to "Order," and properly "crossed," materially simplifies the task of checking a Cashier; but in almost every business the practical exigencies are such that certain payments must be made in cash, and directly such exceptions arise they entirely undermine the safeguard of cheques, in exactly the same way that the most carefully designed system of internal check is valueless if not rigidly carried out in its entirety. It is not, of course, suggested that because some payments must be made in cash nothing is to be gained by making all payments possible by cheque, but merely that when the Cashier occasionally receives cash, even if the bulk of his receipts be by cheque, a detailed supervision is still essential.

It is a wise precaution, as well as a great convenience in practice, to so sub-divide duties that the same person may not be called upon to receive cash on behalf of his employers and also to make payments upon their behalf. If the two sets of duties be confused, an entirely honest Cashier will experience a far greater difficulty in exactly balancing his cash, while a dishonest one has additional opportunities of covering up his irregularities by the introduction of fictitious entries or the suppression of entries recording transactions that have taken place.

A Cashier may conceal embezzlements by omitting to debit himself with moneys received. The first step towards circumventing such irregularities is to so systematise matters that there may be a record of the money having been received in the office *before* it reaches the Cashier. As a rule, it is not desirable that the Cashier should acknowledge the receipt of remittances.



With regard to the comparative merits of the counterfoil and manifold forms of Receipt Book, it may be pointed out that whereas the latter generally (but not necessarily) possesses the disadvantage of being written in pencil, and therefore capable of being subsequently altered, the possibility of bringing the original and the carbon duplicate together again—when they ought, in the absence of fraudulent intent, to be identical—affords a powerful deterrent, and also conclusive evidence when prosecution becomes necessary as a result of discovered irregularities; whereas the Counterfoil Receipt Book possesses no such safeguard, in that although both receipt and counterfoil ought to be written in ink, they might differ in amount owing either to carelessness or to inadvertence, and such a difference would in itself be no evidence of fraudulent intent.

It should be an invariable rule that the takings of each day be paid into the bank daily without any deduction. In the case of a business involving numerous departments, each having the receipt of money, it may be found advantageous to require each department to bank its own receipts; or the balance of advantage may appear to be in favour of requiring each department to hand over its daily receipts to the Chief Cashier, throwing upon him the duty of verifying and subsequently banking the same. The records of subsidiary Cashiers will in this case afford ample evidence wherewith to vouch the transactions of the Chief Cashier.

A form of fraud that has often occurred in such cases is to *delay* the entry of one or more items received. Such a fraud can, however, only be successfully carried out after running the gauntlet of a number of separate systems of check. In the first place the preliminary record of the receipt of the remittance ought to disclose the omission to debit Cash with the item in

question. In the second place, the vouching of the Receipt Book should disclose the discrepancy: if, however, the Receipt Book be not kept strictly upon the prescribed lines it is practically useless for this purpose.

From time to time receipt forms may be spoiled through clerical inaccuracies. Such forms should in all cases be left in the book. Otherwise anyone having access to the Receipt Book may obtain a receipt form and, by marking the counterfoil "spoilt," utilise it without the irregularity being at once apparent. In this connection the very general practice among large business houses of requiring remittances to be acknowledged upon their *own* receipt form cannot be too strongly deprecated. It is suggested that this request should never be complied with in its entirety, but, of course, there can be no harm in the payee affixing his own receipt form to the stereotyped form supplied by the remitter. In the case of exceptional receipts—as, for example, dividends received in insolvencies—the prescribed form must in all cases be used. This, however, need offer no loop-hole for irregularities, for whoever may be deputed to vouch the Receipt Book should make a point of seeing that the forms in connection with such receipts remain intact in the Receipt Book itself. Of course, the main point to be guarded against is that if, for any reason, the person in charge of the Receipt Book can fill up a counterfoil without filling up the body of the receipt, it becomes open to him to detach the latter and to utilise it for his own purposes to acknowledge a remittance which he does not account for, and in respect of which no counterfoil appears in the book.

If moneys be received and not accounted for, in the ordinary course the non-payment of the account in respect of which they were remitted would attract attention. Hence the importance



of separating the duties of Ledger-keeper and Cashier. If, however, the Cashier has access to the Returns Book or Allowances Book, or any other book of first entry from which items may be posted to the credit of Personal Accounts, it is open to him to account for his deficiencies as "Returns" or "Allowances," unless the entries in these books be carefully verified from time to time by someone in authority having a knowledge of the facts. For the same reason it should never be left for the Cashier to determine what debts are to be written off from time to time as irrecoverable. In the case of comparatively small concerns, when it is impossible to differentiate between Cashier and Ledger-keeper, the risks of this form of fraud are greatly increased. Moreover, if there be no systematic checking of the postings, the embezzlement of receipts may (for the time being at least) be hidden by crediting the account of the remitter in the Ledger without any corresponding entry appearing to the debit of the Cash Book, the difference in the balancing of the Ledger which would thus be caused being obviated by debiting that, or some other, Personal Account with a like amount. By this means the risk of discovery may at least be deferred until attention is eventually directed to the non-payment of the falsified debit: such discovery might, in the absence of systematic and detailed checking, be almost indefinitely protracted by the systematic transfer of the item in question from one account to another. Incidentally it may be mentioned that, if the Ledgers be framed upon self-balancing lines, and the Ledger *totals* be extracted instead of the Ledger balances, the difference between the totals of a Departmental Ledger and the totals of the corresponding Adjustment Account in the General Ledger would *primâ facie* draw attention to the existence of unauthorised transfers from one account to another in the Departmental Ledger.

Another form of fraud which is often particularly difficult to detect at once is the holding back of moneys received for a few days. Inasmuch as most dishonesty has its origin in the first place in the "borrowing" of the employer's money, this form of fraud may be said to almost suggest itself to the beginner, who omits to account for a particular remittance during the few days that he wishes to utilise the proceeds, hoping at the end of that time to be able to replace the money, when all will be well. In all probability, however, such moneys are never replaced, and therefore the mode of falsification which was originally embarked upon is continued from time to time until the irregularities are eventually discovered. If all remittances were made by cheques, properly "crossed," they would be useless to the Cashier, and he would therefore have no incentive to omit to account for them; but in every business improperly "crossed" cheques are received from time to time, and, of course, in many businesses there would also be some receipts in coin. These latter especially would be selected for appropriation; but it does not necessarily follow that the persons remitting the coin would be the ones whose remittances were not accounted for in the Cash Book. Under such circumstances two distinguishing features will obtain: (*a*) If such frauds are at all extensive, the amount of actual coin (or postal orders) paid into the bank will be considerably less than normal. (*b*) The "make-up" of the paying-in slip will not correspond with the items in the Cash Book. Whenever a fraud of this description is suspected, owing to the scarcity of cash received, it is therefore an excellent plan to obtain the paying-in slips from the bankers and to compare them, item for item, with the Cash Book.

Another method of concealing a deficiency in cash, closely allied with the preceding, is for the Cashier to find various excuses for never having his Cash Book quite written up to



date. It stands to reason that a Cashier who is two days behind in the writing up of his Cash Book, and the paying in of his receipts, ought to have two days' takings of cash in hand; and unless these figures be actually verified from time to time, the mere fact that he regularly pays into the bank totals agreeing with the totals of the daily takings affords no safeguard against irregularity. In such cases, from time to time at least, it is necessary that the production of the balance in hand should be insisted upon, and compared with the actual receipts up to date. If there should be any good reason why it is really impossible to write up the Cash Book at once, that is no reason why the cash in hand should not be counted, and it will then be available as a record for comparison with the Cash Book entries when they are written up subsequently. The employment of "Daily Balance Books," in which each Cashier is required to record daily the amount of his cash in hand, and how it is made up, is useful, not merely to facilitate the actual balancing, but also to provide a definite record which must always exist as evidence against the Cashier, in that—being his own statement of facts—it commits him to an admittance of the possession of a corresponding amount of money, whereas, if it be not a fact, there is evidence of systematic falsification of accounts.

When the system is regularly in force of requiring each day's takings to be paid into the bank before the next day's receipts are to hand, the importance of verifying the existence of cash in hand is apt to be overlooked. *Primâ facie* there would appear to be no need to count cash in hand if at least once in every 24 hours there is no such item; but the recent case of the *Brighton Empire and Eden Syndicate v. London and County Bank* shows the importance of occasionally counting cash in hand as an additional precaution. In this case the bank was held to have been negligent in allowing the plaintiff's manager

to write up the debit side of the Pass Book, more especially as although the entries agreed in total with the actual amounts paid in from time to time they did not agree in dates, thus allowing the manager in the meanwhile to hold back receipts without detection. It is to be assumed that under ordinary banking systems of account these circumstances were wholly exceptional; but they clearly suggest the importance of occasionally verifying cash receipts up to the moment of verification, instead of being merely content with seeing that the total receipts appear from time to time to be regularly paid into the bank. It is understood that in this case the cash in hand *was* regularly counted, and that the deficiency escaped attention owing to the falsification of dates in the Pass Book. This suggests the importance of obtaining the bankers' certificate verifying the Pass Book balance.

It is, however, in connection with cash payments that the greatest facilities for fraud are afforded, hence the great importance of making all possible payments only by "crossed" cheques, payable to order. If accounts be paid by cash, a certain amount of money must in the nature of things be always left in the Cashier's hands, and this in itself involves the need of additional precautions by way of verification, as well as greatly increased vigilance in the passing of vouchers for payment. When the vicious system of employing one's own stereotyped form of receipt is in force it is the easiest thing in the world for a Cashier to cover his irregularities by forging vouchers acknowledging the receipt of payments that he has misappropriated. Such payments may represent moneys *bonâ fide* due to creditors (in which case they must eventually be made good, if discovery is to be avoided), or they may represent moneys not due—in which case, if the payment has once been passed, practically all risk of discovery in the future is avoided.



With regard to the interception of moneys properly due to trade creditors, if such creditors have personal accounts, and the Ledger clerk is independent of the Cashier, the risk of discovery is, of course, considerable; but the wholly unbusiness-like practice of giving money to Ledger clerks to pay small accounts standing in their respective Bought Ledgers is far commoner than anyone unacquainted with the circumstances would believe. Under most normal circumstances a somewhat unscrupulous, but smart, Ledger clerk would find no difficulty in passing fictitious items to the credit of certain accounts which he knew he would afterwards be deputed to pay in cash, thus obtaining possession of more money than was necessary to discharge the actual liabilities, and being, of course, free to retain the excess. The little difficulty of the amount of the voucher might, of course, be readily overcome either by altering the voucher actually given by the creditor, or by forging another in its place.

Acting in collusion with an outside party it might often be possible to obtain extensive sums by the passing through of invoices in respect of non-existent goods, which invoices would, if duly passed, be paid in due course. The possibility of this risk suggests the importance of requiring the head of the Goods Received Department and the head of the Department ordering the goods to pass each *statement* before payment, as well as the invoices for goods received from time to time; such statements, when passed, should reach the head of the Counting House without the intervention of the clerk in whose Ledger the account is kept.

When payments are made by cash in discharge of liabilities in respect of which *no* personal account has been opened, the risk of fraud is naturally more considerable, inasmuch as the system of internal check employed to verify these items is, as a

rule, proportionately less complete. Hence the importance of, so far as possible, paying all accounts by cheque, and in every case obtaining as much independent testimony as possible of the existence of the liability. The mere fact that all payments are made by cheque is not in itself a complete safeguard, as unless precautions are taken to see that the payee is not a non-existent person, the cheque may fall into the hands of, and be converted into cash by, an employee, or some outside person acting in collusion with an employee.

Practically no difficulty is ever experienced in obtaining duplicates of receipts on the ground that the original has been lost. By a slight alteration of dates such duplicates might often be made to do duty in support of a double payment, one payment having found its way into the pockets of an employee.

Where several undertakings carry on business under the same roof, as, for example, when one man is the Secretary of several companies, or when a merchant is the agent of several manufacturers, vouchers may often be duplicated so that the same item may be charged against two or more companies, or manufacturers, as the case may be. Hence the importance of carefully scrutinising all vouchers, not merely as to name and amount, but also as to date and as to the name of the customer on whose account the receipt is acknowledged.

When passing accounts for payment in respect of which no Ledger Accounts are regularly kept, it is especially important that the invoices and statements should be so distinctively marked as to render it impossible for them to be presented for payment upon a future occasion. Otherwise there is nothing to prevent an invoice (perhaps altered as to date) being presented for payment a second time and passed, the cheque being misappropriated.



It is probably in connection with Wages that the greatest scope for dishonesty in connection with payments is afforded. The total Wages of most business concerns amounts to a very considerable item, the whole of which has, as a rule, to be paid in cash. In large concerns the risk of fraud is further magnified by the fact that no one individual is sufficiently in touch with the facts to be able, of his own knowledge, to verify the correctness of the total in every particular. On the other hand, the larger the undertaking the more readily does it become practicable to institute a really effective system of internal check, upon the principle that at least two persons, who are in no way connected with the remainder of the work, may be made responsible for each section thereof; while, by changing these person's duties from time to time, the risk of collusion is reduced to a minimum. By this means the actual operation of making-up and paying wages may be divided into three sections and deputed to separate groups of employees:—

(1) Those who calculate, and make themselves responsible for, the amount of Wages due to each worker. This section should be sub-divided into those who check (*a*) time or piecework, (*b*) money value.

(2) Those who make themselves responsible for that amount of money, and no more, being drawn out of the coffers of the business and handed to the various paymasters.

(3) Those who make themselves responsible for the actual paying of the exact sums handed to them from time to time for Wages to the persons certified as being entitled to those wages by "group 1."

If this distinction between the three groups be clearly observed, and the respective duties of the three sets of persons kept invariably distinct, and if the individuals charged with the

duties under each section be changed from time to time as opportunity offers, there is little risk of any extensive fraud in connection with the payment of Wages.

In manufacturing concerns it may be added that the institution of a proper system of Cost Accounts is almost invaluable as a check against fraud in the Wages, seeing that Cost Accounts require the allocation of a corresponding amount of work actually performed, in place of a corresponding amount of money paid; and, so long as such work has been performed, the undertaking has satisfied itself upon the most material point.

Minor difficulties may sometimes arise, owing to a dispute as to whether individual workers have actually received the Wages that they are entitled to. Such disputes may take the form of a query as to the correctness of the amount paid, or, in the case of workers absent on pay-day through illness, through the wrong person being paid, or through the paymaster misappropriating the amount. If, however, everything is worked upon a system, such difficulties can hardly occur, and in any case they can only be quite small in amount. It is thought that the proper business method would be to make the employees actually responsible for that part of the work pecuniarily responsible in respect of any deficiencies that may be discovered.

In relatively smaller concerns, or in connection with the accounts of isolated branches, a different form of fraud may occur. If the Wages be worked upon the "Imprest" System, the Branch manager will send in a requisition for a definite sum to pay Wages for the current period, and upon his order (subject to such further verification as may be found expedient) the necessary moneys will be remitted, either in cash or by cheque.



Probably the most convenient plan would be to remit by cheque, giving the Branch manager a sufficient balance to enable him to defray current expenses. If cheques can only be signed at board meetings, and board meetings are not regularly held, it may easily occur that sometimes cheques have to be signed for two or three weeks' Wages at the same board meeting. Unless these requisitions for cheques be carefully verified *before* being passed for payment, there is a risk that advantage may be taken of these irregularities in the dates of board meetings to sometimes ask for a cheque in respect of the same week's Wages at two consecutive board meetings. Cases of this description have occurred in practice; and, what is perhaps even more to the point, it has been held that the mere asking twice for a cheque in respect of the same item, combined with a deficiency when the Branch manager's cash came to be verified at the end of the year, constituted no case to go to a jury on a charge of larceny and falsification of accounts.

When Wages are paid by "piece-work," it is especially important that every possible precaution should be taken to see, not merely that the work in respect of which the payment is asked for has been actually performed, but also that it has been delivered. In particular, when payments are made on account, and not merely in respect of goods actually delivered in a completed form, it is important to see that the earlier processes in respect of the work are not paid for in one week and the *whole* of the processes paid for in the next week. In that case the earlier processes would, of course, be paid for twice over. The proper record of piece-work is in many industries a matter of some intricacy; but on account of its importance, and on account of the extreme likelihood of over-payment in the absence of a really systematic check, the necessary trouble and expense must in all cases be faced.

Pass Books—whether those issued by a bank, a savings bank, a building society, or by tradesmen—are useful as vouchers, so long as adequate precautions are taken to ensure that they are compiled by the persons whose books they are supposed to be —*i.e.*, the bank, savings bank, building society, or tradesman, as the case may be. From the point of view of the undertaking issuing the Pass Books, however, their value is more limited, in that if there be any discrepancy between the Pass Book and the corresponding Ledger Account, that Pass Book will be one of the many that are not available for inspection by the professional or staff Auditors. In practice it is never possible to obtain inspection of *all* Pass Books at the same time, and thus irregularities may, for a time at least, remain undetected. To some extent these risks may be reduced by periodically forwarding a circular to every customer, pointing out to him the state of his account, and asking him to sign the statement as approved, and to return it direct to the Head Office, or to someone other than the person primarily responsible for that particular department of the work. The utility of this precaution is, of course, somewhat limited, owing to the fact that a certain number of customers would always be found not to take the necessary trouble to assist in carrying out this system of check; but the practice is one which is growing in favour with many banks, and might with advantage be extended to savings banks, building societies, &c.

It need perhaps hardly be pointed out that when there are several different tills in the same business house, the amount of cash in hand at any given time can only be verified by requiring production of the cash in each till simultaneously. Otherwise there must always be the risk that one till may borrow from another to temporarily make up its deficiency, and thus the same moneys may be counted several times over and



taken as representing a correspondingly larger amount of cash in hand. This principle applies not merely to banks having several Cashiers, but also to ordinary business concerns, where, in addition perhaps to several receiving Cashiers in the shop (or warehouse), there may be one or more paying Cashiers in the Counting-House, as well as a clerk in charge of the Petty Cash. There should never be a running account for Wages cash; the Wages should be settled up each pay-time, and the balance (if any) paid into the bank.

Another form of fraud that has to be specially .guarded against in connection with financial houses owning branches, is that under which the delinquent materially modifies the effect of communications between the Head Office and the various Branches by adding postcripts to letters that have already been approved, and signed, by the responsible officer. It should in all cases be an inflexible rule that postcripts not signed, or initialled, by the persons signing the body of the letter require confirmation before being acted upon.

In these days, when the old-fashioned Journal has been almost entirely superseded by more modern forms of books of first entry, a difficulty sometimes arises as to the record of some unusual entry. In such cases recourse is sometimes had to the Cash Book, the transaction being recorded upon both sides, and thus not disturbing the balancing of the Cash Book, while from that book it is possible to post the transaction to any desired Ledger Account. The practice, however, of recording through the Cash Book entries that do not relate to the receipt or payment of moneys is to be deprecated, as directly lending itself to the perpetration of irregularities. If once entries be made in the Cash Book which do not relate to the receipt or payment of moneys, it is difficult to draw the exact line between proper and improper entries; while it must be borne in mind that, if such

entries be so made that the two sides do *not* agree, the balance of the Cash Book is correspondingly affected. A complicated entry put through both sides of the Cash Book will readily afford the opportunity of entering a larger sum to the credit than to the debit, the effect of which is to reduce the balance for which the Cashier is accountable, leaving him free to apply the difference to his own purposes with but little fear of detection.

From the point of view of banks, it is quite intelligible that they should for the most part prefer to adhere to their customary system, and not enter moneys paid in by customers in the Pass Book until such moneys have been actually collected—a practice which, of course, involves a discrepancy as to dates between the Cash Book and Pass Book in connection with country cheques, and more particularly in connection with Scottish and Irish cheques and bills paid in "short" for collection. In vouching the Cash Book, however, it is important that especial attention should be given to these items, and that such discrepancies between dates should not be disregarded, upon the assumption that they refer to one or other of the items above enumerated, without first making sure that such is actually the case.

When any considerable number of Bills are discounted, it is very important not merely that the various transactions should be verified in detail, item for item, but also that the amounts charged for discount should in each case be carefully checked. If this precaution be neglected, there is a risk that "long" Bills, not the property of the undertaking, may be substituted by the Cashier for the "short" Bills which he purports to discount, in which case, of course, the undertaking will be charged too much for the accommodation, and the Cashier (by discounting the other Bills elsewhere) may pocket the difference.



The same precautions should in all cases be observed before drawing, or accepting, Bills as would ordinarily be employed before giving debtors a receipt for remittances, or before remitting cheques or cash to creditors in settlement of their accounts. The necessity for this precaution is especially obvious in connection with those who may have occasion to draw, or accept, Bills as agents on behalf of their principals, in which case the Bills may be made out in the names of third parties with whom no Ledger Accounts are kept.

It may perhaps hardly be considered worth while to institute such a detailed system of vouching payments as would involve the payments charged against Petty Cash in respect of telegrams being verified by counting the number of words in the press copies of the telegrams sent; but if telegrams are numerous—as, for example, in the offices of stockbrokers, &c.—such a precaution would certainly be desirable occasionally. In any event the cost of cables—which naturally represents a much larger figure, and usually passes through Petty Cash, because cables have to be paid for in cash—should be carefully verified in this manner.

Reference has already been made to the possibility of defalcations being concealed by the opening of fictitious accounts to restore the "balance" of the Ledgers, which had been destroyed by the crediting thereto of cash which had not passed through the Cash Book. It is important to bear in mind that this form of fraud is much more likely to escape observation at a time when an old Ledger is closed and a new Ledger opened, as this occasion affords a favourable opportunity of transferring balances from one account to another while retaining the aggregate total of the balances as a whole. In many concerns it is the custom to open fresh Departmental Ledgers

each year, so that the balancing and auditing of the books may not interfere with the posting up from day to day of the next year's transactions. The plan has much to commend it upon the score of convenience; but it affords an opening for serious frauds, if the balances are not checked from the old Ledgers into the new ones. The mere fact that the new Ledgers "balance" is no adequate safeguard in itself.

In connection with all systems of internal check, and also in connection with so-called "continuous" audits, it is important to bear in mind the limitations of these systems. Entries which have never been checked by the prescribed parties may be subsequently made in the books, and "ticked," or otherwise marked in the accustomed manner. Also entries which have already been made, and checked, may be subsequently altered. This method of falsification, involving the forging of the staff or professional Auditor's ticks, is often extremely difficult to detect in practice, and no general rules can be laid down for its discovery beyond the suggestion that those in charge of the checking should have impressed upon them the importance of not merely mechanically verifying the agreement of one set of figures with another, but also seeing that the various accounts that come before them from time to time are what they purport to be: records of transactions—*i.e.*, facts. If this be duly appreciated, the difficulty of making such alterations without detection is materially increased, and experience shows that this method of fraud has rarely succeeded for any appreciable period, save when the internal checking has been of a purely mechanical character. Of course, the ordinary precautions known to all experienced Auditors should invariably be insisted upon. Items should never be checked until added in ink, and the additions should be checked simultaneously; erasures should under no circumstances be permitted; and when corrections have to be



made a slightly different form of "tick" should be employed, so that, if such alterations be made subsequently to the checking of the items, they may be at once apparent to the initiated.

When the business is of such a nature that moneys are regularly received from the same persons at specified intervals (as, for example, in connection with insurance premiums, rents, rates, payments under hire-purchase agreements, &c.) it is a good plan to have all receipts written out in advance by clerks in no way connected with the Cashiers' Department. Such receipts may then be handed to the Cashiers, or Collectors, they being required either to account in due course for a corresponding amount of money, or to return the receipts intact.

Miscellaneous receipts of companies, such as transfer fees and charges for copies of Articles of Association, can be readily verified; the former by comparison with the Transfer Receipt Book, the latter by keeping an account of the number of copies of Articles of Association in the custody of the clerk who sells them.

Those upon whom devolves the task of verifying cash balances should be fully instructed as to the extent to which (if at all) the various Cashiers are entitled to make advances. Perhaps the best plan is to require the exact constitution of each separate balance (including, of course, a full specification of all "paper" items) to be submitted to the head of the Counting-House upon each occasion. For the purpose of detecting irregularities of this description a "surprise" audit is, of course, far more effective than one at regular intervals.

If Cashiers are authorised to receive cheques, and to treat them as part of their cash balance, it is important that steps be taken to ensure that any cheque that has once been so

treated as part of a cash balance is without delay paid into the bank. If this precaution be omitted, a deficiency may be concealed by the manufacture of a forged (or other worthless) cheque, which is never paid into the bank, and therefore never presented for payment. This precaution is necessary not merely in connection with the verification of the balances of Departmental Cashiers, but also Chief Cashiers. Indeed, it is a very necessary precaution in connection with the verification of the cash balance of a Bank itself.

## CHAPTER VI.

## SPECIFIC INSTANCES OF FRAUD NOT INVOLVING THE MISAPPROPRIATION OF MONEY.

THE various instances of fraud described in this chapter may be grouped under two headings:—

(*a*) Frauds by which an employee misappropriates money, or money's worth, not the property of his employer.

(*b*) Misappropriations of property other than money, and falsifications having for their object the inflation of the profits of the undertaking, either with a view to concealing the losses caused by his dishonesty, or with a view to misrepresenting the profitable nature of the undertaking, and thus indirectly improving his position.

As the methods employed to a very large extent overlap, no attempt has been made to definitely separate the methods characteristic of each of these various kinds of fraud.

As has already been stated, with an adequate system of accounts it is impossible for any defalcation to remain long undetected unless the accounts are falsified, and if the books be kept by double-entry such falsification must be made twice, thus affording a double chance of detection. The first effect of misappropriations upon the accounts will be to reduce the assets of the concern. If the amount involved be not serious, the

corresponding entry to preserve a balance of the books may be made to the debit of a Nominal Account, thus charging the theft against profits. Serious irregularities cannot, however, be thus dealt with in safety, as a falling off in profits that cannot otherwise be accounted for naturally leads to further inquiry. Extensive misappropriations are therefore usually concealed by false entries inflating other assets, false entries under-stating liabilities, or by additional falsifications crediting Nominal Accounts with a sum to compensate for the debit caused by the misappropriation. It will thus be seen that many of the methods of falsification ordinarily employed by those who have misappropriated the moneys of their employers would equally well serve the purpose of those whose sole object in falsifying the books was to overstate the profits of the undertaking. As will be seen upon reference to the next chapter, such methods of falsification are by no means necessarily confined to employees.

A very rudimentary method of falsification is to manipulate the Trial Balance *after* it has been agreed, transferring certain items from Nominal to Personal or Real Accounts, or *vice versâ*. With a professional audit there is but little risk of such frauds escaping the detection of the auditors; but with an amateur audit, or with no audit at all, the risk is, of course, far more serious, as in such cases, although much care may be taken in checking the technical accuracy of the entries in the books and their extraction on to the Trial Balance, when the latter has once been agreed it is often left under the control of the senior bookkeeper, or other interested party, who can readily make the desired alterations without fear of detection.

In the case of books kept by single-entry, or books which, owing to falsification, do not balance, profits may readily be inflated by errors in the addition of long schedules of balances



representing assets. Such manipulations may be readily performed, if there be no professional audit, by not adding up the schedules until the items of which they are composed have been checked. Afterwards certain figures are increased by the addition of tens of pounds in front of units, hundreds in front of tens, and so on, and the addition of the figures (as altered) correctly made. The checking of the additions at this stage would, of course, detect no irregularities; while the risk of subsequent discovery, through the items being compared with the books at a later stage, may be avoided by subsequently erasing the figures that have been improperly inserted.

When hand-made paper of good quality is employed for books of account, greatly increased facilities are afforded to dishonest bookkeepers, as upon such paper it is quite possible to make erasures without their being apparent to anyone unless the pages are looked at through the light. With machine-made paper, on the other hand, even if of first-class quality, erasures always leave some mark, and thus may be detected by the employment of reasonable circumspection.

If a senior bookkeeper be allowed to make any entries in any book that he likes, without having to explain their nature to his subordinates, it is, of course, a perfectly simple matter for him to misrepresent the position of affairs to any desired extent. If such fictitious entries related to matters within the knowledge of the subordinates it is probable that they might lead to suspicion, and to eventual detection; but if they relate to matters concerning which the clerk in charge of that book has no personal knowledge, no such deterrent exists. The only possible safeguard is to in *all* cases insist upon the rule that each clerk is to keep his own books entirely, and to make no entries therein without being personally satisfied that they are in accordance with the facts.

A very common form of fraud on the part of responsible employees is the suppression, temporarily, of invoices for goods purchased. The Manager of a trading (or manufacturing) department which, for any reason, is not showing the desired amount of profit may be tempted to conceal the unsatisfactory position of affairs by "holding back" invoices for goods purchased immediately prior to the date of balancing, while such goods have been included in the stocktaking as assets. The very prevalent practice of dating invoices "forward," as a means of accommodating customers by allowing them more than the customary rate of credit, tends to facilitate this form of fraud; but with a proper system of verification in the Goods Received Department no difficulty ought to be experienced in its detection, especially if all trade creditors be asked to forward "stocktaking statements" for comparison with the Bought Ledger balances. If, however, such irregularities are not detected by the staff audit, it seems idle to expect that the professional audit will in all cases bring them to light.

A varied form of this same irregularity is to hold back certain invoices, on the ground that they relate to the next season's goods, and that it is therefore misrepresenting the purchases of the current period to include them. So long as the goods in question are excluded from the stocktaking also, there is, of course, something to be said in favour of this view, although its actual effect is to misrepresent the real financial position at the date of the Balance Sheet; but, having by these representations secured the standing over of the invoices, the Departmental Manager may cause some (or all) of the goods to be taken into stock.

If there be a great number of Trade Ledgers, and the books are kept upon self-balancing lines, it has sometimes been thought that, if the books balance, a detailed verification of the



various Trade Ledgers and of their respective schedules of balances is unnecessary. Such detailed verification should always form part of the regular system of internal check, and the professional Auditor should in every case satisfy himself that such an internal check is carried out in its entirety, and that there are in the various Ledgers balances which aggregate to the corresponding amounts to the debit of the respective Adjustment Accounts in the General Ledger. If this practice be neglected, there is a risk that the balances of the Adjustment Account in the General Ledger may be systematically inflated from time to time in order to magnify the profits of the undertaking. A very limited examination of the Trade Ledgers—or of one or more of them, taken at random—would effectually dispose of such a risk.

The value of Stock-in-trade (including under this general heading Movable Plant and Tools) has from time to time been frequently misrepresented with a view to overstating the profits of the undertaking. Here, again, the extent to which the professional audit may prove an adequate safeguard is limited to the extent to which it is practicable for the professional Auditor to see that the fundamental principles of a good system of internal check are carried out in their entirety. At least two persons, familiar with the class of goods being enumerated, should be responsible for the descriptions and quantities entered upon the schedules, and should sign a certificate stating exactly for what they are responsible. At least two persons (preferably the Departmental Manager and the Managing Director or Chairman) should certify as to the accuracy of the prices, which should be specifically stated in the certificate to in no case exceed cost price, and to be correspondingly lower than cost price when the goods have deteriorated in value. Two of the responsible Counting-house clerks should be responsible for the

arithmetical accuracy of the extensions and additions, and should certify accordingly. And, finally, the list, as so priced, extended, added, and summarised, should be referred back to the Departmental Manager and the Managing Director (or Chairman), who should definitely and explicitly accept responsibility for the Stock being included in the accounts as being of that aggregate value. If these precautions be in all cases insisted upon, it is impossible for any deliberate over-valuation to take place without the collusion of at least two persons, if not more. There are cases upon record in which employees have admitted that, acting upon instructions received, they have deliberately over-stated the quantities of goods. It is thought, however, that even such persons would have hesitated to become a party to such frauds, had they been called upon to sign a definite certificate of the form here indicated. A more likely mode of falsification would be to over-price some of the articles in question, and inasmuch as the prices must necessarily be settled by those more or less personally responsible for the financial result, the weakest point in the link of precautions is undoubtedy here. It may be borne in mind, however, that if the correctness of the prices has to be definitely certified *before the calculations are commenced*, there is but little risk of falsification, in that the parties interested have not before them at that moment the detailed information as to the actual value of the Stock. Falsifications of Stock values have, as experience shows, been almost invariably the result of subsequent manipulations, after the actual total had been ascertained. If the method of stocktaking described above be in all cases followed, this risk is to a great extent obviated. Moreover, at least one of the Counting-house clerks charged with the extensions and additions, or with their checking, should be selected from among those whose duty it is from day to day to check the extensions and additions of invoices; by this means he will be (or



ought to be) familiar with the prices of goods sold, and a knowledge on the part of the Departmental Manager that no over-pricing can take place without the knowledge of someone in the Counting-house would unquestionably serve as a useful deterrent.

A Branch Manager may often be tempted to over-state profits, or to conceal losses, by making insufficient provision for Depreciation, Bad Debts, or outstanding Liabilities. In the case of a Head Office, or a large Branch fully equipped, these risks are materially reduced, in that the adjustments referred to would devolve primarily upon the Head of the Counting-house, rather than upon the Manager responsible for the financial results of the current period. When, however, the Branch is not sufficiently large to justify the employment of a really responsible Counting-house Manager, the only precautions available are

(1) To require full Branch Returns to be forwarded from time to time, and to have these carefully scrutinised at the Head Office.

(2) To rely mainly upon the integrity of the Branch Manager.

(3) To from time to time send someone from the Head Office to inspect and thoroughly scrutinise the Branch affairs.

In all cases the provision of a local professional audit will be found a useful and comparatively inexpensive safeguard. If the concern is not sufficiently large to justify the existence of a competent Counting-house Manager, the cost of a complete local audit could scarcely be heavy.

When the system of accounts in use is one that does not include an ample verification of Cost Accounts by reconciling them with the results shown by the financial books, considerable scope is offered to the Factory Manager to falsify results,

with a view to the aggrandisement of his office. The principle involved is one of the oldest known in connection with the falsification of accounts; but, owing to improved bookkeeping, it has become almost obsolete, save under the circumstances named. When the nature of the transactions is such that, whenever the books are balanced, a certain number of contracts are always in progress, which are not closely scrutinised until (at a subsequent date) they are completed, it is always possible for the Factory Manager to show satisfactory results in connection with those contracts that have been completed during the period under review by transferring part of the cost of materials in respect of those contracts to others that are still in progress. By this means a series of unprofitable contracts may each be made to show a profit in completion, so long as the business continues to be carried on upon the same, or a larger, scale. Of course, if at any time the business were discontinued, and thus no new contracts undertaken, the last contracts completed would, under these circumstances, show a heavy loss, which would represent not merely the loss upon those particular contracts, but the whole accumulation of postponed losses in respect of all prior unprofitable contracts. The *modus operandi* usually employed in such cases is to credit contracts just completed—or just about to be completed—with the value of materials returned from other contracts still in progress. To enable a sufficiently large sum to be thus credited to the wrong contract the materials forwarded to contracts still in progress are often greatly in excess of the legitimate requirements of those contracts. This method of fraud is facilitated by the circumstances under which these returns of materials are ordinarily recorded: the work usually devolves upon men of the artisan class, who, however reliable in themselves, certainly cannot be regarded as experts in matters of account. Such persons, if conscientious, will doubtless carefully check the quantities and values of goods



with the accompanying stores warrants before passing on the record, but they are not likely to inquire very closely into the number of the contract from which the goods were received. If, therefore, the stores warrant is made out to the credit of the wrong contract, the error is hardly likely to be discovered under ordinary circumstances, unless special precautions be taken.

With the same object in view all classes of cost expenses may be wrongly allocated, so as to give the benefit to a contract finished before the date of balancing at the expense of a contract which is then still in progress; and, as has already been said, so long as there is always a sufficiency of contracts in progress this method of falsification may be continued almost indefinitely. Practically the only means of guarding against this form of fraud are (1) to require two or more persons, other than the Manager responsible for the success of the contract, to certify *which* contract is to receive the benefit of goods returned from headquarters; (2) to entirely separate the Cost Department from the control of the Works Managers, and to instruct all cost clerks to be particular to verify records, not merely as to the amount of money involved, but as to the identity of the contract concerned; (3) to systematically reconcile cost records with the records of the financial books; (4) to periodically scrutinise in detail the constitution of each item that represents the cost of all uncompleted contracts.

In the case of an undertaking which *inter alia* manages the affairs of others as Agent (as, for example, a shipping manager, a consignee, or the managing partner of a syndicate or other joint venture) the opportunity often arises to misrepresent the aggregate profits of the undertaking by misinterpreting the nature of the terms under which one, or more, of these various joint ventures are undertaken. By over-stating the manager's

profits, or commission, as the case may be, the aggregate profits may easily be enhanced to a material extent without the accounts appearing manifestly improper to any of the parties concerned. This form of falsification is often rendered the more easy by the fact that the original document expressing the terms of the contract of management may be in the hands of a third party, and in consequence a copy is accepted as evidence in its stead. Whenever a copy document is accepted as a voucher in place of an original document, steps should be taken to verify its accuracy—if possible by comparison with the original, if not by securing its certification by some independent person, preferably the solicitor of the co-partners or syndicate.

In some financial concerns very large powers are given to Branch Managers, which in effect enable them to speculate with the moneys of their employers with a view to profit. Cases are not unknown in which Managers have speculated on behalf of their employers, and also upon their own account, so manipulating matters that whenever a transaction proved unprofitable the loss was charged to the employer. It is, of course, only reasonable to assume that such wide powers would never be granted to a Manager in whom the most implicit confidence was not imposed; but, none the less, it is desirable that all such transactions should be closely scrutinised. Certain definite rules should be laid down as to the terms upon which a Manager is allowed to speculate. For example, it should be clearly understood from the outset that the Manager is not allowed to speculate on his own account and on account of his employers through the same brokers. Perhaps a better rule still would be to provide that the Manager must under no circumstances speculate for his own account *at all*, upon penalty of whatever profits might be made by him being deemed to have been received by him in trust for his employers. Speaking in general terms, however, such wide powers ought not, under any circumstances, to be deputed to employees.



Another class of fraud, which appears to have been very greatly upon the increase of late, possesses the notable distinction that it in no way affects the financial books of the undertaking. For this reason it is apt to be overlooked under any normal system of supervision. In connection with any registered or Parliamentary company, or in connection with the Stock issued by any local authority, after the issue has been once completed the financial books of the undertaking are in no way affected by subsequent transfers of stock, or shares, from one holder to another. Yet, notwithstanding the fact that these transfers in no way affect the financial books of the undertaking, and are therefore apt to be left outside any scheme of internal check, they afford perhaps the readiest means of misappropriation that can well be conceived. The employees who have charge of the Transfer Department have under their control the Certificate Books: they also have it in their control to give certificates that certain stock, or shares, are in the office waiting the lodgment of transfer. Under the somewhat slack system that is very commonly in force they have also, upon occasions, access to the Seal of the undertaking, which they can affix to any document that they may think desirable. They are thus enabled (at the risk of committing forgery, it is true) to produce what are to all appearance *bonâ fide* certificates of stocks, or shares, as the case may be. Under these circumstances it is not a difficult matter for an expert bookkeeper to duplicate shares, and, by selling such duplicates, to secure the benefit of whatever purchase-money may be paid by *bonâ fide* purchasers for their acquisition. If the inevitable effect of such falsification were to be that a certain number of shares, or a certain amount of stock, had to remain permanently duplicated, there would, of

course, always be a considerable risk of discovery when the annual audit came round; for although it is usually regarded as being no part of the statutory duty of a professional Auditor to verify transfers in detail, yet it is the practice of most firms of repute to satisfy themselves that the aggregate balances on the Share, or Stock, Ledgers agree with the actual amount that has properly been issued. This, however, is not in itself an adequate safeguard against all possibilities of fraud in this connection. If the tendency is for the price of a certain class of shares to rise, employees connected with the Transfer Department may be tempted to "bull" the shares in the hope of a profit later on. If the rise in the market be delayed, the temptation to "hedge" by selling, and to manufacture certificates for delivery when the next settlement takes place, is undoubtedly strong; and if there appears to be a reasonable hope that, long before the next audit comes round, the "manufactured" certificates may be taken off the market and destroyed, so as to restore the original aggregate total, the temptation has under some circumstances proved irresistible. It need perhaps hardly be pointed out that this form of fraud offers fewer risks of detection in the case of Stock than in the case of Shares having distinctive numbers. In the absence of grave suspicion, however, no such detailed investigation of the Share Accounts would ever be embarked upon as would be likely to disclose the existence in duplicate of shares having the same distinctive number, unless the falsifications were carried on to an extent entirely over-riding the limits of discretion. The fact remains that such frauds have upon several occasions been successfully carried on for a considerable period of time without detection, and have involved very large sums of money.

Of course, if the Secretary of the Company—and *à fortiori* if one or more of the Directors—act in collusion, the risks of discovery are enormously minimised.



By way of conclusion, a few words may be added as to defalcations involving the theft of stock-in-trade, or other movable assets belonging to the undertaking. The most obvious precaution with a view to minimising the risk of losses arising from this cause is to establish a definite system of espionage, under which nothing of any description is allowed to leave the business premises without a permit from headquarters. With regard to portable articles, however, such a system must necessarily prove of limited utility, and in connection with these no hard-and-fast system is likely to prove of much utility. Reliance must be placed chiefly upon the heads of departments, and upon their responsible assistants, to keep close observation upon all that takes place. When goods of considerable intrinsic value, and of portable nature, are dealt with—as, for example, jewellery—a very complete system of Stock Accounts should in all cases be used, and stock-on-hand should be verified with the Stock Books every night before it is placed in the strong-room prior to leaving the premises for the night. If the articles in question are not of sufficient intrinsic value to render this precaution practicable, its rigour may be somewhat relaxed according to circumstances, and according to the experience of the undertaking concerned. In an extreme case practically the only check that could usefully be employed will be the check of the periodical inventory at stocktaking, which in the case of stock-in-trade means that so long as the customary rate of gross profit is realised it will not be practicable to inquire into details too closely. This from the point of view of the Counting-House and the professional Auditor, will represent the *minimum* available system of check; but no Departmental Manager who is worth his salt would be content with such a minimum, and a Manager who allowed leakages to continue until they were discovered at stocktaking may unquestionably be said to have clearly demonstrated his unfitness for his position.

A Manager, or employee, who appears to be so desirous of obliging customers as to transact business at irregular hours, and away from the business premises, is always to be regarded, if not with suspicion, at least with careful observation. More particularly does this apply to transactions involving the receipt of money, for under the circumstances it is natural that a properly authorised acknowledgment cannot be given at the time. Such proceedings, therefore, by their very nature render defalcation easy, and may in some cases be said to have actually suggested it. In the provinces—more particularly in rural or semi-rural districts, where business methods are not well understood—customers may actually bring pressure to bear upon cashiers and others to accept money from them upon irregular occasions, professing that they require no formal receipt, and are quite satisfied to leave the money with the cashier without any acknowledgment. It is especially in connection with Savings Banks, Building Societies, and Friendly Societies that such unbusinesslike methods have been found to lead to fraud, and in many recorded instances there is but little doubt that the special facilities offered by the too confiding afforded the incentive that led to the first downward step. Employers, and those who act for them, may thus be specially cautioned against allowing such an irregular state of affairs to continue. Business houses would, moreover, be well advised to, upon all necessary documents, state clearly that under no circumstances will they hold themselves responsible for moneys paid to employees, other than within the fixed hours and under authorised circumstances; and that in all cases their liability must be limited to the amount of such acknowledgment as may have been given (1) by their authorised agents, (2) upon the prescribed form of receipt.

## CHAPTER VII.

## SPECIFIC INSTANCES OF FRAUD.

### FALSIFICATIONS OF DIRECTORS AND PROPRIETORS.

PROPERLY speaking, the Director of a Company is one of its employees, and therefore from many points of view a system of check designed to detect fraud upon the part of employees should be sufficiently elastic to cover the misdoings of Directors as well. In practice, however, the powers and the position of Directors are—rightly or wrongly—closely associated with those of partners rather than of employees: hence they may be more conveniently grouped with the former than with the latter. The cases upon record in which Directors have been guilty of falsification as a means of concealing misappropriations of moneys are extremely few, for the organisation of even small Companies is such as to throw considerable difficulties in the way of such misappropriation on the part of Directors, who very rarely have the handling of moneys belonging to the Companies by which they are employed. Their falsifications are, under all ordinary circumstances, limited to misrepresentations as to the general position of the undertaking for one, or another, of the reasons mentioned in Chapter IV. That is to say, the motive of the fraud is, as a rule, similar to the motive that induces the proprietor, or the joint proprietor, of a business to falsify its accounts, the advantage sought to be gained being indirect, rather than direct.

At the same time, it is well to bear in mind that, here as elsewhere, there is no rule without an exception. Directors have, as a rule, few (if any) facilities for embezzling the moneys belonging to the Company to an extent sufficient to afford any powerful inducement to commit a criminal offence; but, by virtue of their position, they have often the power to pledge the assets of the Company as security for advances, and cases are upon record in which such a power has been abused to secure advances, not for the benefit of the Company, but for the benefit of the individual Director. This form of fraud has also from time to time been perpetrated by Managers, but it is only in quite a limited number of industries that Managers would have any implied power to pledge the assets of the undertaking. As examples of the irregularity referred to may be mentioned the case of the Managing Director of a Single-Ship Company, who mortgaged the ship as security for an advance made to him personally. This fraud emphasises the importance of the Auditor in all cases verifying, not merely the actual existence of the assets enumerated in the books, but also their existence *free from all encumbrances save those therein recorded.* In the case of Ships, mortgages have to be registered at the Custom House: the Auditor should therefore in all cases inspect the Register, with a view to seeing what (if any) charges have been registered against the ships in question.

Similarly in the case of Stocks and Shares, it may be perfectly legitimate to pledge these from time to time as security for temporary advances; but only, of course, if the advances are to, or for the benefit of, the Company. The Auditor should satisfy himself as to the existence of all such investments, free from encumbrances other than those duly recorded, at the date of the Balance Sheet. In the case of all but Inscribed Stocks this can be performed by the actual production of the stock



certificates; but in the case of both stocks and shares, the distinctive numbers of the certificates should be noted, with a view to seeing not merely that the proper quantity is accounted for, but also that the original asset has not been disposed of and another of equivalent value substituted by the time the next audit becomes due. In the case of Inscribed Stocks the certificate of the banker acting as agent, addressed direct to the Auditor, should in all cases be obtained; and it is important to bear in mind that such certificate will only serve its purpose if it relates to the date of the Balance Sheet.

When, as is usually the case, the Auditor's inspection takes place some little time after the date of the Balance Sheet, it is especially important to make all due inquiries to make sure not merely that the assets are intact at the date of inspection, but also that they were intact at the date of the Balance Sheet, and in particular stocks and shares purchased subsequently must not be accepted in substitution of those that ought to have been in existence upon the date under review. Again, stocks sold, and therefore eliminated from the books, but not delivered, must under no circumstances be confused with stocks which at the date of the accounts were properly the property of the undertaking.

If, for any reason, there should be a difficulty in verifying the actual amount of these assets at the date of the accounts, it will be found some safeguard for the Auditor to satisfy himself that the dividends acknowledged as having been received from time to time have actually been remitted from the undertaking whose stocks or shares are held. This will afford at least an assurance that such investments were actually in existence, and will be a safeguard against the familiar fraud under which actual moneys have been embezzled, but the periodical income duly

accounted for. If the counterfoils of the original dividend warrants are produced, they will at least afford some evidence of the fact that the investments in question stood to the credit of the undertaking.

In some cases, for varying reasons, the investments are not registered in the name of the Company, but in the name of nominees. In such cases it is especially important to verify their existence, and a declaration of trust executed by the nominees should also be called for, which declaration should recite in detail the particulars of the investments so held.

All that has been stated in the previous chapter in connection with the falsification of stock values applies with equal force here. The uncorroborated certificate of a Director should no more be accepted than the uncorroborated certificate of an employee; but the two combined are of value, as each supplying a check upon the other. And if in addition certificates can be obtained from persons of a wholly different class, who in the nature of things are unlikely to be in collusion with a Director, the evidence as to the facts is, of course, greatly strengthened. It is very important to bear in mind further that men of the artisan class will often sign certificates "to order" without fully appreciating the importance of what they are doing. A certain amount of personal cross-examination may then often be employed with advantage, as tending to clear up all outstanding doubts that there may be in respect of these items.

The same remarks apply with regard to the valuation of Work in Progress.

As to the proper provision for Bad and Doubtful Debts, it depends greatly upon the nature of the business whether the actual initiative in making such provision will come from the Directors, or one of them, or from the Manager. In any event,



it is important to fix the ultimate responsibility for the accuracy of the provision upon both; neither should be in a position to subsequently assert that he had relied upon the other's estimate and can take no responsibility in the matter.

Another form of fraud, which is so audacious as—within limits—to be almost safe, is to forge the Auditor's certificate appended to the foot of the periodical Balance Sheet. Such a fraud is hardly likely to have its initiation at the Board of Directors, for in the nature of things it could hardly be undertaken by the Directors without the collusion of their subordinates. It is, however, mentioned here because it is so clearly part of the duty of a Board of Directors to see that the accounts *are* duly audited that they can hardly be absolved from all blame if this precaution has been neglected. There is a case upon record in which for a number of years the signature of a firm of London Chartered Accountants was forged to the accounts of a provincial undertaking. The fraud owed its success to the relative unimportance of the concern; indeed, the audit being a small one, the Auditors did not even trouble to inquire why it was that their services were not requisitioned, assuming that the Company had either ceased to carry on business, or else that a different firm of Auditors had been appointed. The mere fact that such frauds have occurred in the past suggests that, in the interests of the public, accountants should always make it a point to inquire why, when they have once been appointed Auditors, they are not called upon to discharge their duties at the accustomed times.

Another set of circumstances under which accounts may be issued with the Auditor's certificate attached without his authority having ever been obtained in the first instance is where, to save time, the accounts have been placed in the

printer's hands with the customary certificate appended, and have been subsequently issued before the Auditor's signature has been actually added to the accounts. If the accounts are in order, and are eventually certified by the Auditor, no great harm will result; but in other cases the responsibility of all parties concerned would appear to be sufficiently serious, although, strangely enough, in the case of municipal corporations no penalties appear to be provided for this very serious form of misrepresentation. In such cases, however, in the nature of things the damage that may possibly ensue is not likely to be serious; for the Auditor, being actually engaged upon the audit, is hardly likely to overlook the irregularity, or to fail to take such steps as may be necessary to place the true facts before the parties interested.

When the Vendors to a Company control the Board, and have a distinct interest in the maintenance of the expected dividend, cases have been known in which they will deliberately enter into such business relations with the Company as will enable it to earn the desired rate of profit. In some cases such arrangements have been entered into through the mediation of a nominee; the object being, of course, to produce accounts showing the required rate of profit, whether or not it has been actually earned out of the legitimate business of the undertaking. Such frauds would naturally be unprofitable to the Vendors, if continued indefinitely; but they may well be profitable to them, if the conditions of purchase were such as to materially reduce the purchase-price if the anticipated rate of profit were not realised for each of the first three years. Again, if the Vendor receives, as part consideration of purchase-money, a considerable block of Ordinary Shares in the Company, it may well be worth his while to inflate the profits of the Company during the first few years, even at some direct personal expense, for the



sake of enhancing the market value of the shares, so as to enable him to "unload" upon the market. If skilfully conducted, such frauds could not possibly be disclosed by the ordinary professional audit, and in the majority of cases, if perpetrated with sufficient ability, they might not even arouse the suspicion of employees. The problem is, moreover, further complicated by the fact that, so long as the transactions are such as to cause the Company to *earn* the profits stated by the accounts, the accounts themselves are not fraudulent, whatever the motives of the vendor Directors may have been; while the ultimate result is, of course, that the shareholders as a body, and particularly those who purchased the shares of the vendor Directors in the market, are defrauded.

It is desirable that Auditors, and also responsible Managers, should make it their business to as far as possible ascertain the names of all other concerns in which the Directors are interested. This is desirable not merely with a view to throwing light upon the class of fraud just mentioned, but also in view of the Company being prejudiced by entering into *un*profitable business transactions with other concerns in which the Directors (or some of them) are more heavily interested. In connection with banks, and other financial undertakings, it is particularly important that advances to customers who are in any way identified with the Directors should be very carefully scrutinised, and that ample security for such advances should in all cases be obtained.

A mode of manipulating accounts which may, in unscrupulous hands, easily degenerate into fraud is that connected with the formation and maintenance of Secret Reserves. A Secret Reserve represents some difference between the actual known facts and the facts recorded in the books of an undertaking, or in its

published accounts, of such a nature that the position recorded by the latter is less favourable than the facts themselves. Within reasonable limits the existence of Secret Reserves is not merely permissible, but desirable. Almost all Balance Sheet figures, so far from representing actual facts, are but estimates, and consequently it is permissible that conservative estimates should be employed. Here, however, as in many other cases, the actual position of affairs can hardly be gauged without an inquiry into motives. If the motive, or, to express it in other words, the "policy" of the Board, is to under-state the profitable nature of the undertaking with a view to persuading shareholders, or some of them, to sell their holdings (in which event the Directors, or their friends, propose to buy), such "policy" is but another name for a fraudulent conspiracy.

This consideration leads to a general inquiry as to the legitimacy of Directors speculating in the shares of the undertakings they direct. It can, it is thought, be hardly contested that such speculations are in all cases undertaken upon the strength of information which has been acquired by the Directors in their capacity as servants of the undertaking. It can further scarcely be denied that such operations are of a secret character. Under these circumstances it is thought that the law with regard to the matter is clear, and that such profits could in all cases be recovered by the Company from the Directors, as being a secret profit earned by them in their capacity as agents; but, apart from the law, the mere fact that these operations are invariably conducted secretly, and in the names of nominees, shows that even in the opinion of those who embark upon them they are something to be ashamed of. It should be added, however, that a Director, merely because he is a Director, is not thereby precluded from buying or selling shares in the ordinary course, or from making a profit upon such transactions. Like



every other shareholder, he retains his freedom of action as an individual; but by virtue of his fiduciary position he must in all cases run the risk of criticism, and the further risk of being called to account for any profits he may have made by virtue of his position without the knowledge of his employers. So long as Directors do not abuse the trust imposed in them it is hardly likely that any shareholder would be so unreasonable as to suggest that under no circumstances whatever was it competent for a Director to have any dealings in the shares of the Company.

The most difficult frauds to detect, and also the most serious frauds that have been perpetrated by Directors, have been undertaken in connection with Companies formed into "groups," having, as a rule, a majority of Directors common to the Boards of two or more Companies. Such arrangements offer facilities to the unscrupulous to "ring the changes" upon transactions as between one Company and another, so that those transactions may, when scrutinised by the Auditors of each Company in turn, appear to be perfectly *bonâ fide*, whereas were the accounts and records of each Company open to the Auditors, or open to the same Auditor, simultaneously, the frauds would be at once apparent. There doubtless are legitimate advantages to be derived from the association of Companies into groups, but it would hardly be over-stating the case to say that the experience so far obtained from such organisations is that at all events the majority of those that have gone into liquidation have been proved to be fraudulent almost from their inception. Groups of Companies offer special difficulties to Auditors, in that such Companies, if fraudulent, are virtually frauds perpetrated by two or more Companies acting in collusion, whereas the records of only one are available for the inspection of the Auditor. If, therefore, the fraud be carried through with any ability whatever,

all evidence of conspiracy may be very readily concealed. The following paragraphs deal with a few examples of frauds in connection with groups of Companies.

What is known as "window-dressing" may be properly described as the legitimate practice of setting one's house in order shortly before the date of the Balance Sheet, with a view to, so far as possible, converting floating assets into cash, and in other ways completing pending transactions so as to enable the full profit in respect thereof to be taken credit for. This process has naturally the effect of materially increasing the amount of profits earned during the last few weeks of the financial period as compared with the remainder of that term, and the further effect of increasing the working capital and especially the free cash balance. So long as the operation is *bonâ fide*, it is manifestly legitimate, because the position of affairs disclosed by the published Balance Sheet, even if slightly better than the normal position from day to day, is none the less upon that ground an actual *fact;* and the mere circumstance that this position of affairs can be produced by legitimate means, and without wrecking the Goodwill of the concern, is of itself a sufficient demonstration of the fact that the undertaking is in a healthy condition. If, however, the position of affairs is such that the whole of the capital of the undertaking is locked up, and that therefore no legitimate "window-dressing" is possible, its counterfeit presentment may be produced, in the case of one of a group of Companies, by that Company entering into transactions with others of the same group, which are not *bonâ fide*, and which are embarked upon for the express purpose of deceiving interested parties as to the true position of affairs. "Window-dressing" of this description can only be regarded as a fraudulent conspiracy upon the part of those responsible.



Such a conspiracy may take several forms. In so far as its object is to improve the complexion of the Balance Sheet by inflating the floating assets, and especially the cash resources of the undertaking, that undertaking may borrow from an allied Company for a few days round the date of the Balance Sheet. The moneys so borrowed serve, of course, no useful purpose to the Company, but suffice to throw dust in the eyes of the shareholders as to the true position of affairs. It would be impossible to suggest that such borrowing was embarked upon for any legitimate purpose. Cases have been known in which the bank balance has been fraudulently inflated by passing through cheques upon the date of the Balance Sheet, which did not really represent money at all, in that they were for a larger amount than the available bank balance of the drawer of the cheque. Thus if two concerns, each having a balance of £50 on the 31st December, hand each other a cheque for £1,000, and both cheques are paid into the bank, say, at 3 o'clock upon the last day of the year, then upon the two Pass Books being made up, *each* account will show a balance of £1,050 at the bank. By fraudulently post-dating the counterfoils of these £1,000 cheques a like balance may be shown in the Cash Book of each concern, and if the Cash Book be not written up for January until after the audit takes place, the essentially unreal nature of the whole transaction may easily escape the Auditor. Such a barefaced fraud is, however, rarely necessary; for, by the simple expedient of balancing the books of each of a group of allied Companies upon a date different to the others, the necessity of crowding the transactions into the same day is entirely obviated, if any one member of the group possesses a free balance at its bankers.

The legitimate practice in "window-dressing," of endeavouring to clear up all pending contracts, or old transactions, so as

to secure credit for the resultant profit in the period under review, finds its counterfeit in the fraudulent group of Companies in transactions under which each Company not about to balance its books will enter into contracts with the Company that is about to balance its books, under which the latter makes large profits at the expense of the former, upon the understanding that such consideration is to be reciprocated later on as each of the other Company's periods for balancing come round. This fraud is upon the principle already described upon page 54 in connection with the manipulation of uncompleted contracts, regarding each Company as a completed contract when its date of audit comes round, and as an uncompleted contract at every other time of the year.

Another mode of manipulation which is very commonly carried on in connection with groups of Companies—but not necessarily confined to groups—is as follows:—The A. Company, having participated in the promotion of the B. Company, becomes possessed of a certain number of shares of a face value considerably in excess of the expenditure originally incurred in connection with such promotion. Pending the realisation of the shares of the B. Company, it is clear that in the books of the A. Company they cannot be valued at a price in excess of their original cost; that is to say, no profit in respect of the flotation of the B. Company can be taken credit for, save as and when the shares in the B. Company are realised. In connection with a group of Companies this process of realisation of course presents no difficulties. The A. Company, on the eve of its Balance Sheet, sells its holding in the B. Company to another member of the same group at a large profit, which profit is taken credit for in the accounts of the A. Company as a realised profit. The purchasing Company, C., will continue to hold the shares until the date of its Balance Sheet draws near,



when it will pass them on at an enhanced figure to the D. Company, which (in its turn) will sell them back, say, to the A. Company at a profit; and so the vicious circle may be continued.

The danger of this form of fraud is, of course, that realised profits are, in the nature of things, regarded as calling for no special verification. The implied undertaking on the part of the A. Company to eventually buy back the same shares at a still higher price is, of course, entirely suppressed, and therefore the loss which must eventually be realised in respect of this deal is overlooked. Moreover, if the A. Company holds the bulk of the B. Company's shares, or of any particular class of such shares, it may well be worth its while to also control the market price of those shares, so manipulating matters that the price at which these shares change hands from time to time may always appear to be the genuine market value of the shares at the date of such sale. It should be borne in mind that, in connection with large blocks of shares held by the same holder, or the same group, it is usually (for a time at least) possible to control the market so that the market price from time to time may be no indication whatever of the intrinsic value of the shares in question, or even of their value upon the basis of supply and demand in a free market. Such manipulations are, of course, far easier in connection with a group of companies than in connection with one isolated Company; but even in the latter case a fraud of this description may be easily perpetrated with the aid of a Director, or other interested party, possessed of sufficient means to purchase the shares temporarily, upon the understanding that he is afterwards to be allowed to sell them back to the Company at a profit.

In connection with the possibilities of fraud on the part of Directors, attention may especially be directed to the case

already mentioned upon page 56, of Managers speculating both on their own account and on account of the Company they represent, and afterwards re-shuffling the transactions so as to secure a substantial profit to themselves, no matter how these speculations may turn out. The opportunities of fraud thus offered to the Managing Director of a Finance Company are only limited by his personal integrity. No scheme of control that can be devised is likely to prove altogether effective, the more so as it may be plausibly advanced that such speculations could not be in all cases advantageously conducted in the name of the Company. At the same time, it ought not to be impossible to arrive at a definite working arrangement as to the names of nominees in which the Company's transactions are to be recorded, leaving the Director free to speculate in other names he may choose for his own transactions. Shareholders, however, who are content to earn profits by this means must not be surprised if the results are not invariably satisfactory.

Many of the methods of fraud already enumerated are applicable to the case of the Proprietor of a business, who is desirous of inflating its profits with a view to eventually securing a partner at a substantial premium; and they may also be perpetrated during the continuance of the partnership when the arrangement is such that the total amount to be paid by the incoming partner in respect of Goodwill is to be based upon the profits earned by the firm during (say) the first few years. Naturally it is worth the while of the original Proprietor to divide bogus profits with his co-partner for a time, if in return for such payments he can eventually secure a far larger sum in payment of Goodwill; and what applies in this connection to an original Proprietor seeking a partner applies *à fortiori* to a Proprietor desirous of selling the whole of his business to someone prepared to purchase it at a price based either upon past results



or upon the results of the next few years. As in the case of companies serious frauds are greatly facilitated by companies working in groups, so in the case of individuals such frauds may be perpetrated with greater immunity, if the leading spirit concerned therein is also interested in other undertakings which have business relations with the concern immediately under review.

Speaking generally with regard to the classes of fraud referred to in this chapter, it may be stated that in connection with frauds perpetrated by principals, as also with frauds perpetrated by employees, while to a large extent the professional audit may afford a safeguard, its chief value in practice is less in the direction of what it is able to itself directly perform than in the direction of organising a regular system of internal check, which by systemising and diffusing responsibility makes all forms of fraud difficult, if not impossible, without such collusion as is unlikely to arise in practice. Moreover, a system of fraud offers few temptations, even to the unscrupulous, unless there is a likelihood of its being successfully maintained for such considerable period of time as will allow of the results proving sufficiently profitable to afford adequate compensation for the serious (and, of course, in the case of collusion, especially serious) risks undertaken.

# APPENDIX.

THE following extracts from Acts of Parliament constitute the more important provisions in the statute law relating to fraud in accounts.

## THE LARCENY ACT, 1861.

### (24 & 25 Vict. c. 96.)

SECTION 3.—Whosoever being a bailee of any chattel, money, or valuable security, shall fraudulently take or convert the same to his own use or the use of any person other than the owner thereof, although he shall not break bulk or otherwise determine the bailment, shall be guilty of larceny, and may be convicted thereof, upon an indictment for larceny, but this section shall not extend to any offence punishable on summary conviction.

SECTION 68.—Whosoever being a clerk or servant, or being employed for the purpose or in the capacity of a clerk or servant, shall fraudulently embezzle any chattel, money, or valuable security which shall be delivered to or received or taken into possession by him for or in the name of or on the account of his master or employer, or any part thereof, shall be deemed to have feloniously stolen the same from his master or employer, although such chattel, money, or security was not received into the possession of such master or employer otherwise than by the actual possession of his clerk, servant, or other person so employed, and being convicted thereof shall be liable, at the discretion of the Court, to be kept in penal servitude for any term not exceeding fourteen years and not less than three years, or to be imprisoned for any term not exceeding two years, with or without hard labour, and with or without solitary confinement, and if a male under the age of sixteen years, with or without whipping.



SECTION 72.—If upon the trial of any person indicted for embezzlement or fraudulent application or disposition as aforesaid, it shall be proved that he took the property in question in any such manner as to amount in law to larceny, he shall not by reason thereof be entitled to be acquitted, but the jury shall be at liberty to return as their verdict that such person is not guilty of embezzlement or fraudulent application or disposition, but is guilty of simple larceny, or of larceny, as a clerk, servant, or person employed for the purpose or in the capacity of a clerk or servant, or as a person employed in the public service, or in the police, as the case may be; and thereupon such person shall be liable to be punished in the same manner as if he had been convicted upon an indictment for such larceny; and if upon the trial of any person indicted for larceny it shall be proved that he took the property in question in any such manner as to amount in law to embezzlement, or fraudulent application or disposition as aforesaid, he shall not by reason thereof be entitled to be acquitted, but the jury shall be at liberty to return as their verdict that such person is not guilty of larceny, but is guilty of embezzlement, or fraudulent application or disposition, as the case may be, and thereupon such person shall be liable to be punished in the same manner as if he had been convicted upon an indictment for such embezzlement, fraudulent application or disposition; and no person so tried for embezzlement, fraudulent application or disposition, or larceny as aforesaid, shall be liable to be afterwards prosecuted for larceny, fraudulent application or disposition, or embezzlement, upon the same facts.

SECTION 75.—Whosoever having been intrusted, either solely or jointly with any other person, as a banker, merchant, broker, attorney, or other agent, with any money or security for the payment of money, with any direction in writing to apply, pay, or deliver such money or security, or any part thereof respectively, or the proceeds of any part of the proceeds of such security, for any purpose, or to any person specified in such direction, shall, in violation of good faith, and contrary to the terms of such direction, in anywise convert to his own use or benefit, or the use or benefit of any person other than the person by whom he shall have been so intrusted, such money, security, or proceeds, or any part thereof respectively; and whosoever having been intrusted, either solely or jointly with any other person, as a banker, merchant,

broker, attorney, or other agent, with any chattel or valuable security, or any power of attorney for the sale or transfer of any share or interest in any public stock or fund, whether of the United Kingdom, or any part thereof, or of any foreign State, or in any stock or fund of any body corporate, company, or society, for safe custody, or for any special purpose, without any authority to sell, negotiate, transfer, or pledge, shall, in violation of good faith, and contrary to the object or purpose for which such chattel, security, or power of attorney shall have been intrusted to him, sell, negotiate, transfer, pledge, or in any manner convert to his own use or benefit, or the use or benefit of any person other than the person by whom he shall have been so intrusted, such chattel or security, or the proceeds of the same, or any part thereof, or the share or interest in the stock or fund to which such power of attorney shall relate, or any part thereof, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to be kept in penal servitude for any term not exceeding seven years and not less than three years, or to be imprisoned for any term not exceeding two years, with or without hard labour, and with or without solitary confinement; but nothing in this section contained relating to agents shall affect any trustee in or under any instrument whatsoever, or any mortgagee of any property, real or personal, in respect of any act done by such trustee or mortgagee in relation to the property comprised in or affected by any such trust or mortgage; nor shall restrain any banker, merchant, broker, attorney, or other agent from receiving any money which shall be or become actually due and payable upon or by virtue of any valuable security, according to the tenor and effect thereof, in such manner as he might have done if this Act had not been passed; nor from selling, transferring, or otherwise disposing of any securities or effects in his possession upon which he shall have any lien, claim, or demand entitling him by law so to do, unless such sale, transfer, or other disposal shall extend to a greater number or part of such securities or effects than shall be requisite for satisfying such lien, claim, or demand.

SECTION 76.—Whosoever being a banker, merchant, broker, attorney, or agent, and being intrusted, either solely, or jointly with any other person, with the property of any other person for safe custody, shall, with intent to defraud, sell, negotiate, transfer, pledge, or in any



manner convert or appropriate the same or any part thereof to or for his own use or benefit, or for the use or benefit of any person other than the person by whom he was so intrusted, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the punishments which the Court may award as hereinbefore last mentioned.

SECTION 77.—Whosoever being intrusted, either solely, or jointly with any other person, with any power of attorney for the sale or transfer of any property, shall fraudulently sell or transfer or otherwise convert the same or any part thereof to his own use or benefit, or the use or benefit of any person other than the person by whom he was so intrusted, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the punishments which the Court may award as hereinbefore last mentioned.

SECTION 78.—Whosoever being a factor or agent intrusted, either solely, or jointly with any other person, for the purpose of sale or otherwise, with the possession of any goods, or of any document of title to goods, shall, contrary to or without the authority of his principal in that behalf, for his own use or benefit, or the use or benefit of any person other than the person by whom he was so intrusted, and in violation of good faith, make any consignment, deposit, transfer, or delivery of any goods or document of title so intrusted to him as in this section before mentioned, as and by way of a pledge, lien, or security for any money or any valuable security borrowed or received by such factor or agent at or before the time of making such consignment, deposit, transfer, or delivery, or intended to be thereafter borrowed or received, or shall, contrary to or without such authority, for his own use or benefit, or the use or benefit of any person other than the person by whom he was so intrusted, and in violation of good faith, accept any advance of any money or valuable security on the faith of any contract or agreement to consign, deposit, transfer, or deliver any such goods or document of title, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the punishments which the Court may award as hereinbefore last mentioned; and every clerk or other person who shall knowingly and wilfully act and assist in

making any such consignment, deposit, transfer, or delivery, or in accepting or procuring such advance as aforesaid, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the said punishments: Provided that no such factor or agent shall be liable to any prosecution for consigning, depositing, transferring, or delivering any such goods or documents of title, in case the same shall not be made a security for or subject to the payment of any greater sum of money than the amount which at the time of such consignment, deposit, transfer, or delivery was justly due and owing to such agent from his principal, together with the amount of any bill of exchange drawn by or on account of such principal and accepted by such factor or agent.

SECTION 79.—Any factor or agent intrusted as aforesaid, and possessed of any such document of title whether derived immediately from the owner of such goods or obtained by reason of such factor or agent having been intrusted with the possession of the goods, or of any other document of title thereto, shall be deemed to have been intrusted with the possession of the goods represented by such document of title; and every contract pledging or giving a lien upon such document of title as aforesaid shall be deemed to be a pledge of and lien upon the goods to which the same relates; and such factor or agent shall be deemed to be possessed of such goods or document, whether the same shall be in his actual custody, or shall be held by any other person subject to his control, or for him or on his behalf; and where any loan or advance shall be *bonâ fide* made to any factor or agent intrusted with and in possession of any such goods or document of title on the faith of any contract or agreement in writing to consign, deposit, transfer, or deliver such goods or documents of title, and such goods or documents of title shall actually be received by the person making such loan or advance, without notice that such factor or agent was not authorised to make such pledge or security, every such loan or advance shall be deemed to be a loan or advance on the security of such goods or document of title within the meaning of the last preceding section, though such goods or document of title shall not actually be received by the person making such loan or advance till the period subsequent thereto; and any contract or agreement, whether made direct with such factor or agent, or with any clerk or other person on his behalf, shall be deemed a contract or



agreement with such factor or agent; and any payment made, whether by money or bill of exchange or other negotiable security, shall be deemed to be an advance within the meaning of the last preceding section; and a factor or agent in possession as aforesaid of such goods or document shall be taken, for the purposes of the last preceding section, to have been intrusted therewith by the owner thereof, unless the contrary be shown in evidence.

SECTION 80.—Whosoever being a trustee of any property for the use or benefit, either wholly or partially, of some other person, or for any public or charitable purpose, shall, with intent to defraud, convert or appropriate the same or any part thereof to or for his own use or benefit, or the use or benefit of any person other than such person as aforesaid, or for any purpose other than such public or charitable purpose as aforesaid, or otherwise dispose of or destroy such property or any part thereof, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the punishments which the Court may award as hereinbefore last mentioned: Provided that no proceeding or prosecution for any offence included in this section shall be commenced without the sanction of Her Majesty's Attorney-General, or, in case that office be vacant, of Her Majesty's Solicitor-General: Provided also that where any civil proceeding shall have been taken against any person to whom the provisions of this section may apply, no person who shall have taken such civil proceeding shall commence any prosecution under this section without the sanction of the Court or Judge before whom such civil proceeding shall have been had or shall be pending.

SECTION 81.—Whosoever being a director, member, or public officer of any body corporate or public company, shall fraudulently take or apply for his own use or benefit, or for any use or purposes other than the use or purposes of such body corporate or public company, any of the property of such body corporate or public company, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the punishments which the Court may award as hereinbefore last mentioned.

SECTION 82.—Whosoever being a director, public officer, or manager of any body corporate or public company, shall as such receive or

possess himself of any of the property of such body corporate or public company otherwise than in payment of a just debt or demand, and shall, with intent to defraud, omit to make or to cause or direct to be made a full and true entry thereof in the books and accounts of such body corporate or public company, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the punishments which the Court may award as hereinbefore last mentioned.

SECTION 83.—Whosoever being a director, manager, public officer, or member of any body corporate or public company, shall, with intent to defraud, destroy, alter, mutilate, or falsify any book, paper, writing, or valuable security belonging to the body corporate or public company, or make or concur in the makng of any false entry, or omit or concur in omitting any material particular in any book of account or other document, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the punishments which the Court may award as hereinbefore last mentioned.

SECTION 84.—Whosoever being a director, manager, or public officer of any body corporate or public company, shall make, circulate, or publish, or concur in making, circulating, or publishing, any written statement or account which he shall know to be false in any material particular, with intent to deceive or defraud any member, shareholder, or creditor of any such body corporate or public company, or with intent to induce any person to become a shareholder or partner therein, or to intrust or advance any property to such body corporate or public company, or to enter into any security for the benefit thereof, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the Court, to any of the punishments which the Court may award as hereinbefore last mentioned.

SECTION 85.—Nothing in any of the last ten preceding sections of this Act contained shall enable or entitle any person to refuse to make a full and complete discovery by answer to any bill in equity, or to answer any question in interrogatory in any civil proceeding in any Court, or upon the hearing of any matter in bankruptcy or insolvency; and no person shall be liable to be convicted of any of the



misdemeanours in any of the said sections mentioned by any evidence whatever in respect of any act done by him, if he shall at any time previously to his being charged with such offence have first disclosed such act on oath, in consequence of any compulsory process of any Court of law or equity in any action, suit, or proceeding which shall have been *bonâ fide* instituted by any party aggrieved, or if he shall have first disclosed the same in any compulsory examination or deposition before any Court upon the hearing of any matter in bankruptcy or insolvency.

SECTION 86.—Nothing in any of the last eleven preceding sections of this Act contained, nor any proceeding, conviction, or judgment to be had or taken thereon against any person under any of the said sections, shall prevent, lessen, or impeach any remedy at law or in equity which any party aggrieved by any offence against any of the said sections might have had if this Act had not been passed; but no conviction of any such offender shall be received in evidence in any action at law or suit in equity against him; and nothing in the said sections contained shall affect or prejudice any agreement entered into or security given by any trustee, having for its object the restoration or repayment of any trust property misappropriated.

SECTION 87.—No misdemeanour against any of the last twelve preceding sections of this Act shall be prosecuted or tried at any Court of General or Quarter Sessions of the Peace.

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## THE FORGERY ACT, 1861.

### (24 & 25 Vict. c. 98.)

SECTION 23.—Whosoever shall forge or alter, or shall offer, utter, dispose of, or put off, knowing the same to be forged or altered, any undertaking, warrant, order, authority, or request for the payment of money, or for the delivery or transfer of any goods or chattels, or of any note, bill, or other security for the payment of money, or for procuring or giving credit, or any indorsement on or assignment of any such undertaking, warrant, order, authority, or request, or any

accountable receipt, acquittance, or receipt for money or for goods, or for any note, bill, or other security for the payment of money, or any indorsement on or assignment of any such accountable receipt, with intent, in any of the cases aforesaid, to defraud, shall be guilty of felony, and being convicted thereof shall be liable, at the discretion of the Court, to be kept in penal servitude for life or for any term not less than three years, or to be imprisoned for any term not exceeding two years, with or without hard labour, and with or without solitary confinement.

SECTION 25.—Whenever any cheque or draft on any banker shall be crossed with the name of a banker, or with two transverse lines with the words "and Company," or any abbreviation thereof, whosoever shall obliterate, add to, or alter any such crossing, or shall offer, utter, dispose of, or put off any cheque or draft whereon any such obliteration, addition, or alteration has been made, knowing the same to have been made with intent, in any of the cases aforesaid, to defraud, shall be guilty of felony, and being convicted thereof shall be liable, at the discretion of the Court, to be kept in penal servitude for life or for any other term not less than three years, or to be imprisoned for any term not exceeding two years, with or without hard labour, and with or without solitary confinement.

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## THE LARCENY (AMENDMENT) ACT, 1868.

### (31 & 32 Vict. c. 116.)

SECTION 1.—If any person being a member of any co-partnership, or being one of two or more beneficial owners of any money, goods or effects, bills, notes, securities, or other property, shall steal or embezzle any such money, goods or effects, bills, notes, securities, or other property of or belonging to any such co-partnership, or to such joint beneficial owners, every such person shall be liable to be dealt with, tried, convicted, and punished for the same as if such person had not been or was not a member of such co-partnership or one of such beneficial owners.



## FALSIFICATION OF ACCOUNTS ACT, 1875.

### (38 & 39 Vict. c. 24.)

SECTION 1.—That if any clerk, officer, or servant, or any person employed or acting in the capacity of a clerk, officer, or servant, shall wilfully and with intent to defraud, destroy, alter, mutilate, or falsify any book, paper, writing, valuable security, or account which belongs to or is in the possession of his employer, or has been received by him for or on behalf of his employer, or shall wilfully and with intent to defraud make or concur in making any false entry in, or omit or alter, or concur in omitting or altering, any material particular from or in any such book, or any document or account, then in every case the person so offending shall be guilty of a misdemeanour, and be liable to be kept in penal servitude for a term not exceeding seven years, or to be imprisoned with or without hard labour for any term not exceeding two years.

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## BANKERS' BOOKS EVIDENCE ACT, 1879.

### (42 Vict. c. 11.)

SECTION 3.—Subject to the provisions of this Act, a copy of any entry in a banker's book shall in all legal proceedings be received as *primâ facie* evidence of such entry, and of the matters, transactions, and accounts therein recorded.

SECTION 4.—A copy of an entry in a banker's book shall not be received in evidence under this Act unless it be first proved that the book was at the time of the making of the entry one of the ordinary books of the bank, and that the entry was made in the usual and ordinary course of business, and that the book is in the custody or control of the bank.

Such proof may be given by a partner or officer of the bank, and may be given orally, or by an affidavit sworn before any Commissioner or person authorised to take affidavits.

SECTION 5.—A copy of an entry in a banker's book shall not be received in evidence under this Act unless it be further proved that the copy has been examined with the original entry and is correct.

Such proof shall be given by some person who has examined the copy with the original entry, and may be given either orally or by an affidavit sworn before any Commissioner or person authorised to take affidavits.

SECTION 6.—A banker or officer of a bank shall not, in any legal proceeding to which the bank is not a party, be compellable to produce any banker's book, the contents of which can be proved under this Act, or to appear as a witness to prove the matters, transactions, and accounts therein recorded, unless by order of a Judge made for special cause.

SECTION 7.—On the application of any party to a legal proceeding a Court or Judge may order that such party be at liberty to inspect and take copies of any entries in a banker's book for any of the purposes of such proceedings. An order under this section may be made either with or without summoning the bank or any other party, and shall be served on the bank three clear days before the same is to be obeyed, unless the Court or Judge otherwise directs.

## STAMP ACT, 1891.

### (54 & 55 Vict. c. 39.)

SECTION 14.—(1) Upon the production of an instrument chargeable with any duty as evidence in any Court of civil judicature in any part of the United Kingdom, or before any arbitrator or referee, notice shall be taken by the Judge, arbitrator, or referee of any omission or insufficiency of the stamp thereon; and if the instrument is one that may be legally stamped after the execution thereof, it may, on payment to the officer of the Court whose duty it is to read the instrument, or to the arbitrator or referee, of the amount of the unpaid duty, and the penalty on stamping the same, and of a further sum of one pound, be received in evidence, saving all just exceptions on other grounds.

(2) The officer, or arbitrator, or referee receiving the duty and penalty shall give a receipt for the same, and make an entry in a book kept for that purpose of the payment and of the amount thereof,



and shall communicate to the Commissioners the name or title of the proceeding in which, and of the party from whom, he received the duty and penalty, and the date and description of the instrument, and shall pay over to such person as the Commissioners may appoint the money received by him for the duty and penalty.

(3) On production to the Commissioners of any instrument in respect of which any duty or penalty has been paid, together with the receipt, the payment of the duty and penalty shall be denoted on the instrument.

(4) Save as aforesaid, an instrument executed in any part of the United Kingdom, or relating wheresoever executed to any property situate, or to any matter or thing done or to be done, in any part of the United Kingdom, shall not, except in criminal proceedings, be given in evidence, or be available for any purpose whatever, unless it is duly stamped in accordance with the law in force at the time when it was first executed.

## FRIENDLY SOCIETIES ACT, 1896.

### (59 & 60 Vict. c. 25.)

SECTION 55 (1).—Every officer of a registered society or branch having receipt or charge of money shall, at such times as by the rules of the society or branch he should, render account upon demand made or notice in writing given, or left at his last usual place of residence, give in his account as may be required by the society or branch, or by the trustees or committee thereto, to be examined and allowed or disallowed by them, and shall on the like demand or notice pay over all sums of money, and deliver all property in his hands or custody to such person as the society or branch or committee or trustees appoint.

In case of any neglect or refusal to deliver the account, or to pay over the sums of money, or to deliver the property in manner aforesaid, the trustees or authorised officers of the society or branch may sue upon the bond or security before mentioned, or may apply to the County Court, or to the Court of summary jurisdiction, and the order of either such Courts shall be final and conclusive.

## COMPANIES ACT, 1900.

### (63 & 64 Vict. c. 48.)

SECTION 28.—If any person in any return, report, certificate, Balance Sheet, or other document required by or for the purposes of this Act, wilfully makes a statement false in any material particular, knowing it to be false, he shall be guilty of a misdemeanour, and shall be liable on conviction on indictment to imprisonment for a term not exceeding two years, with or without hard labour, and on summary conviction to imprisonment for a term not exceeding four months, with or without hard labour, and in either case to a fine in lieu of or in addition to such imprisonment as aforesaid: Provided that the fine imposed on summary conviction shall not exceed one hundred pounds.

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(2) For the purposes of this section the expression "company" includes any company formed for purposes of gain and incorporated by charter, or by or under any Act of Parliament, and also any society or body of persons which is registered, or the rules of which are registered, by or with the Registrar of Friendly Societies, under any Act of Parliament.

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